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In the Supreme Court of the United States

OCTOBER TERM, 1988

STATE OF IDAHO *ex rel.* Wayne Soward, Director of the Department of Insurance; STATE OF IDAHO, as liquidator for Pacific Insurance Administrators, Inc., and Pacific Insurance Administrators Agency, Inc.,
Petitioners,

vs.

UNITED STATES OF AMERICA and the INTERNAL REVENUE SERVICE, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

The Idaho Insurers Supervision, Rehabilitation, and Liquidation Act is a comprehensive statutory scheme regulating all aspects of insurance company business, including a priority scheme for the payment of creditor claims for insolvent insurance companies. Claims of the federal or any state or local government, including tax claims, are treated as Class 5 in the priority scheme. In direct conflict, the Federal Insolvency Statute, 31 U.S.C. Section 3713, provides that debts due the federal government as a claimant by any insolvent entity are to be paid ahead of all other debts.

The questions presented are:

1. Whether Idaho's comprehensive statutory scheme for the regulation of insurance companies, including insolvent insurance companies and claimants of those companies, constitutes the "business of insurance" for purposes of the McCarran-Ferguson Act?

2. Whether under the McCarran-Ferguson Act, priority of creditor claims against an insolvent insurance company is governed by Idaho's comprehensive statutory regulatory scheme or by the Federal Insolvency Statute which gives federal government claims first priority.

LIST OF PARTIES

The parties to the proceedings below were Petitioners, the State of Idaho *ex rel.* Wayne Soward, Director of the Department of Insurance; the State of Idaho, as liquidator for Pacific Insurance Administrators, Inc., and Pacific Insurance Administrators Agency, Inc.; and Respondents, United States of America and the Internal Revenue Service, et al.

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UNITED STATES OF AMERICA and the INTERNAL REVENUE SERVICE, et al.,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners, the State of Idaho *ex rel.* Wayne Soward, Director of the Department of Insurance; the State of Idaho, as liquidator for Pacific Insurance Administrators, Inc., and Pacific Insurance Administrators Agency, Inc., respectfully pray that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled proceeding on September 7, 1988, rehearing denied October 31, 1988.

OPINIONS BELOW

The decision of the United States Court of Appeals for the Ninth Circuit is reported at 858 F.2d 445 (9th Cir. 1988), and is reprinted in the Appendix hereto, commencing at A1.

The decision of the United States District Court for the District of Idaho is reported at 662 F.Supp. 60 (D. Idaho 1988), and is reprinted in the Appendix hereto, commencing at A29.

The order of the United States Court of Appeals for the Ninth Circuit denying the petition for rehearing is reprinted in the Appendix hereto, commencing at A37.

JURISDICTION

Invoking federal jurisdiction under 28 U.S.C. Sections 1331(a) and 2410, Petitioners brought this interpleader action in the United States District Court for the District of Idaho. Based upon stipulated facts, on May 20, 1987, the District Court entered judgment on behalf of Petitioners, ruling that Idaho Code governed the priority of tax debts due to the United States.

Respondents appealed, and on September 7, 1988, the United States Court of Appeals for the Ninth Circuit entered an opinion reversing the judgment of the District Court and remanding to the District Court for further disposition of the case. A timely petition for rehearing was filed on September 20, 1988, and an order entered denying the petition for rehearing on October 31, 1988.

The jurisdiction of this Court to review the judgment of the United States Court of Appeals for the Ninth Circuit is invoked pursuant to 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

1. 15 U.S.C. Section 1011, *et seq.*, the McCarran-Ferguson Act (reprinted in full commencing at A38).

2. 31 U.S.C. Section 3713, Priority of Government Claims (reprinted in full commencing at A39).

3. Idaho Code Section 41-3301, *et seq.*, Idaho Insurers Supervision, Rehabilitation, and Liquidation Act (reprinted in full commencing at A40).

STATEMENT OF THE CASE

A. The History of Pacific Insurance Administrators, Inc. and Pacific Insurance Administrators Agency, Inc.

Petitioner State of Idaho *ex rel.* Wayne Soward, Director of the Department of Insurance ("the Director"), is serving as liquidator of Pacific Insurance Administrators, Inc. ("PIA") and Pacific Insurance Administrators Agency, Inc. ("PIAA"). Petitioner holds this position by virtue of his appointment under Idaho Code Section 41-3318 as liquidator for PIA and PIAA.

PIA and PIAA encountered financial problems, chief of which was the companies' inability to pay valid policyholder claims on an ongoing basis. In February 1983, the Petitioner agreed to his appointment as liquidator of the companies. During the liquidation process, the United States submitted claims for federal taxes, including penalties and interest owed by the insurance companies. Petitoner assigned the debts the priority pursuant to the Idaho Insurance Code, Idaho Code Section 41-3342. That priority was disputed by the Respondents.

B. The Idaho Statutory Scheme Regulating Insurance Companies.

Idaho's comprehensive statutory scheme codified at Idaho Code Section 41-3301, *et seq.*, the Idaho Insurers Supervision, Rehabilitation, Liquidation Act, hereinafter the "Idaho Act," regulates all business of insurance companies from the date of incorporation until the wind-up of their affairs is completed. Idaho law vests the Director of the State Department of Insurance with specific powers which broaden when the company enters a liquidation proceeding. Idaho Code Section 41-3321. The Director has plenary power to protect the rights of not just general creditors, but those of all interested parties. In order to protect the interests of all parties, the Idaho Insurance Code sets forth a specific priority system for determining the order of payment from the assets of PIA and PIAA. Idaho Code Section 41-3342. With the exception of administrative expenses incurred in the liquidation proceeding, policyholder premiums are given first priority. Debts of the federal government as well as other governmetnal entities are treated as Class 5 claims in order to fulfill the primary statutory purpose of protecting policyholder interests. Idaho Code Section 41-3342(5).

C. The Liabilities of PIA and PIAA Greatly Exceed Its Assets.

The federal taxes at issue herein, as Class 5 priority claims, would not be paid based upon the funds available for distribution to claimants. The United States disputed the priority assigned to its claim, asserting that it was entitled to payment ahead of Class 4 claims. The liquidator therefore set aside sufficient funds to satisfy the government's claims herein and thereafter brought this

interpleader action seeking a judgment that the claims of the United States were Class 5 claims and that the Director had no personal liability under the Federal Insolvency Statute, 31 U.S.C. Section 3713, hereinafter "FIS," for payment of any claims ahead of those of the United States. The United States answered, asserting a priority for the taxes due, requesting a judgment for the amount of those taxes, and requesting an order that the interpled funds be paid over to the United States.

D. The Decisions of the Courts Below.

The case was submitted to the District Court for judgment to be entered based upon stipulated facts. The United States contended that the FIS governed the priority of tax debts due and that it was therefore entitled to payment ahead of Class 4 claimants. The Petitioner contended that by virtue of the McCarran-Ferguson Act, 15 U.S.C. Section 1012(b), hereinafter the "McCarran Act," state law controlled the priority of the federal government's claims, and pursuant to Idaho law, they were properly prioritized as Class 5 claims. The District Court concluded that state law, specifically Section 41-3342 of the Idaho Code governed the priority of the tax debts due the United States. The Court properly recognized that the priority provision was a small part of Idaho's comprehensive statutory scheme for the regulation of insurance companies as set forth in the Idaho Act. The Court also recognized that Idaho's general regulatory scheme governs the business of insurance from creation through dissolution and therefore regulates the business of insurance within the meaning of the McCarran Act. The Court therefore entered judgment in favor of Petitioner.

The Ninth Circuit Court of Appeals reversed the District Court's decision in holding that Idaho's priority scheme

does not regulate the business of insurance for McCarran Act purposes. *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988). In doing so, the Court refused to apply this Court's most recent decisions interpreting the McCarran Act, *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979) and *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119 (1982). The Court reasoned that the three-part test developed in those two cases is tailored to address activities of insurance companies which implicate the antitrust laws, and is inapplicable to a case arising under a state's regulatory purposes. *Id.* at 453. The Court therefore relied on *Securities & Exchange Commission v. National Securities, Inc.*, 393 U.S. 453 (1969), to define the "business of insurance" in state regulatory scheme cases.

While the Ninth Circuit recognized that states generally have broad authority to regulate the business of insurance companies in liquidation, the Court noted that state statutes to be free from preemption by general federal statutes must relate to "the business of insurance." Relying upon *National Securities*, the Court limited the definition of "business of insurance" to the relationship between the insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement, emphasizing the relationship between insurer and insured. *Id.* at 452. The Court held with little analysis that Idaho Code Section 41-3342 does not regulate the business of insurance because insurance companies in liquidation are no longer in the busness of insurance. *Id.* The Court likened the relationship between an insolvent insurance company and its policyholder as one between debtor and creditor. *Id.* The Court therefore concluded

that the priority scheme in the Idaho Insurance Code did not regulate the "business of insurance" within the meaning of the McCarran Act and was therefore superseded by the FIS. *Id.* at 453.

In so doing, the Ninth Circuit rejected the Petitioner's argument which had been accepted by the District Court that the case should be analyzed by examining the entire statutory scheme set forth in Idaho Code, rather than Section 41-3342. The Court reversed the District Court's decision, vacated the judgment and remanded for distribution of PIA's and PIAA's remaining assets. The Ninth Circuit subsequently rejected a timely filed petition for rehearing without opinion.

REASONS FOR GRANTING THE WRIT

The Ninth Circuit's decision that a general application statute such as the FIS overrides the specific provisions of a state regulatory scheme and that the state's scheme for regulating insolvent insurance companies, including the payment of policyholder claims, does not constitute regulation of the business of insurance for purposes of the McCarran Act raises several important unresolved questions.

I

THE McCARRAN-FERGUSON ACT MANDATES THAT THE IDAHO INSURANCE CODE GOVERN THE PAYMENT PRIORITY OF CREDITOR CLAIMS AGAINST AN INSOLVENT INSURANCE COMPANY.

At issue in this case are direct conflicts between two federal statutes and between one of those federal statutes

and a state statute. The statutes may not coexist in harmony without a decision of this Court delineating the proper reach of each of the statutory provisions. The federal statutes at issue are the McCarran Act, 15 U.S.C. Section 1011, *et seq.*, whose primary purpose is to ensure continued state regulation of the business of insurance, and the Federal Insolvency Statute, 31 U.S.C. Section 3713, whose purpose is to generate income for the federal government. The FIS, as applied by the Ninth Circuit below, also conflicts directly with Idaho Code Section 41-3342 which contains a priority scheme for the payment of claims of an insolvent insurance company, and in this case, places the priority of federal claims behind those of many other claimants. Resolution of this significant question will provide necessary guidance to two industries: (1) the insurance industry which has relied upon state regulation in conducting its business; and (2) state insurance departments which in reliance upon the McCarran Act have pervasively regulated in this area.

A. This Court's McCarran Act Decisions.

This Court has never previously addressed the conflict between the FIS and the McCarran Act. The McCarran Act has allowed the states to develop significant expertise in regulating the business of insurance companies. That expertise extends to insurance companies in liquidation which, while no longer selling insurance policies, are still engaged in business necessitated by having sold those policies in the first place. Consistent with the state regulatory approach, the industry has grown and matured based upon state regulation and could be seriously jeopardized if the Ninth Circuit's decision

is not overturned. The holding below that a general application statute such as the FIS invalidates a portion of the McCarran Act has placed a cloud of uncertainty over a multibillion-dollar industry that thrives on stability.

Central to the confusion evidenced by the Court's interpretation of the McCarran Act is uncertainty among the Circuits as to how to define the term "business of insurance" as set forth in that Act. While the McCarran Act has received comparatively frequent attention, it has arisen almost exclusively in the antitrust context. This Court has not construed the primary regulatory feature of the McCarran Act in 30 years as this Court's attention has been directed to the antitrust exemption. The scope of those limited application antitrust exemption cases has been ever-broadened by the lower Federal Courts as evidenced by the Ninth Circuit's decision in this, a case once again involving the statute's primary purpose of insuring continued state regulation of the business of insurance.

Properly interpreted, the decisions of this Court provide a path for resolving the conflicts among these various statutes. In *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1869), this Court adopted a narrow interpretation of the business of insurance by focusing only on the insurance policy itself. *Id.* at 183-184. *Paul* established the rule of law for 75 years, until this Court's subsequent decision in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), wherein the Court overruled *Paul* and adopted an expansive definition of the business of insurance. In the *SEUA* Court's view the business of insurance included not only the contract but the negotiations and events prior to execution of the contracts

and the innumerable transactions necessary to performance of the contracts. *Id.* at 537 and 538. Those transactions certainly contemplate matters at issue in this case, including payment of losses by the insurer and claims adjusting.

In response to *South-Eastern Underwriters* Congress passed the McCarran Act, 15 U.S.C. Section 1011 to reaffirm that continued state regulation and taxation of the business of insurance is in the public interest. *See, Uncle Sam versus the Insurance Commissioners: A Multi-Level Approach to Defining the "Business of Insurance" under the McCarran-Ferguson Act,* 25 WILLAMETTE L.REV. 1, 28-32 (1989). While some have termed the McCarran Act decisions of this Court emasculation of the McCarran Act by judicial activism, Kimball & Heaney, *Emasculation of the McCarran-Ferguson Act: A Study in Judicial Activism,* 1985 UTAH L.REV. 1 (1985), this Court's first post-McCarran decision actually is enough to resolve the issue in this case.

In *Prudential Insurance Co. v. Benjamin,* 328 U.S. 408 (1946) the Court upheld the constitutionality of the McCarran Act. In so doing, the Court adopted an expansive interpretation of the phrase "business of insurance" similar to the definition in *South-Eastern Underwriters,* noting that the "business of insurance" included events from the inception of the policy until the time the beneficiary thereof was paid. *Id.* at 416 n. 15. Those are activities which were being performed by the Petitioners in this case on behalf of the now insolvent insurance company.

The next major decision of this Court was *Securities & Exchange Commission v. National Securities, Inc.,* 393

U.S. 453 (1969), the case relied upon by the Ninth Circuit below. This Court defined "business of insurance" to include at various points the fixing of rates; the selling and advertising of policies; licensing of companies and their agents; the relationship between insurer and insured; the type of policy which could be issued, its reliability, interpretation and enforcement (the core of the "business of insurance") and other activities which relate closely to their status as reliable insurers; and, finally, the statutes aimed at directly or indirectly regulating the "business of insurance." *Id.* at 458-460. This Court's expansive definition was consistent with the fundamental understanding in the industry that adjustment and payment of claims are two of the most important functions of insurance. *See,* Howard, *Defining the "Business of Insurance,"* 25 WILLAMETTE L.REV. at p. 42 n. 25. Those are activities engaged in by Petitioners in this case, including investigation and adjustment of claims, payment of loss, and attempts to revitalize or sell off the remaining portions of the company's business.

As noted previously, the decisions of this Court in *Royal Drug* and *Pireno,* including the three-part test utilized therein, do not detract from this analysis as by their own terms they interpret only the isolated antitrust exemption of the McCarran Act, not the McCarran Act's broad statutory purpose. However, one facet of *Pireno* is important by analogy. In *Pireno,* this Court determined that the peer review process at issue therein was not equivalent to claims adjusting and therefore part of the "business of insurance" because the peer review process was not binding and involved parties wholly outside the insurance industry. *Pireno,* 458 U.S. at 134 n. 8. The decision implied that had the adjustment process been

performed by parties within the insurance industry and been binding, it would have been part of the "business of insurance." The Petitioner is within the industry and was adjusting and paying claims in a binding manner and should therefore presumably fall within the definition of "business of insurance" contemplated in *Pireno*.

This Court's decisions support a finding that Petitioner was engaged in the business of insurance in adjusting and paying claims on behalf of an insolvent insurer. The Idaho statutory priority scheme prescribes the manner in which claims will be paid, thereby determining both who, how and why claims are paid, consistent with this Court's decisions in *National Securities, South-Eastern Underwriters,* and *Prudential Insurance*. It is therefore a statute which regulates the business of insurance for McCarran Act purposes and it is therefore exempt from the operation of the Federal Insolvency Statute.

B. Conflict Among the Circuits.

The conflicting rationales are best evidenced by contrasting the Ninth Circuit's decision in this case with that of *Gordon v. United States Department of Treasury*, 846 F.2d 272 (4th Cir. 1988). The lower court in *Gordon* was applying the Maryland Insurance Code provisions for priority of payment to the assets of a bonding insurance company with assets sufficient to pay less than 2 percent of its claims. The Maryland Insurance Code mandated that in such circumstances payments be made to claimants only on a *pro rata* basis. The government was a policyholder on some claims on the basis of performance and payment bonds which had been issued, but nevertheless demanded dollar-for-dollar payment of its claims under the FIS, instead of the *pro rata* payment it would

receive under the Maryland Insurance Code. The District Court decided the case on cross-motions for summary judgment, and narrowly construed the McCarran Act antitrust exemption as set forth in *Pireno*. The Court therefore concluded that the McCarran Act was inapplicable and that the FIS governed in lieu of the Maryland Insurance Code.

Evident from the Fourth Circuit's decision is the stark contrast between its rationale and that of the Ninth Circuit below. The Fourth Circuit utilized the test articulated in that narrow scope of cases which interpret the McCarran Act in light of the federal antitrust laws, which include *Pireno* and *Royal Drug*. The Ninth Circuit, on the other hand, specifically ruled that neither *Pireno* nor *Royal Drug* was necessary to decide this case, and instead relied exclusively on *National Securities*. The divergent analyses of the two Circuits point to this Court's need to clarify the analysis lower federal courts should use in applying the McCarran Act.

The Ninth Circuit's decision is also inconsistent with the decisions of other Federal Circuit and District Courts. In *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980) and *Law Enforcement Insurance Co. v. Corcoran*, 807 F.2d 38 (2d Cir. 1986), *cert. den.*, 41 U.S. 1017 (1987), the Second Circuit recognized that the McCarran Act defers the regulation of insurer insolvency to state regulation. These cases stand for the proposition that state regulation of insolvent insurance companies is part and parcel of the state's regulation of insurance for which there is an express federal policy of noninterference. In *Washburn v. Corcoran*, 643 F.Supp. 554 (S.D.N.Y. 1986), the District Court for the Southern District of New York, in reliance

on *Levy v. Lewis, supra,* decided that a state law providing for the rehabilitation and liquidation of an insurance company constituted "laws regulating the business of insurance." The sweeping language of the Ninth Circuit to the contrary is directly contrary to the rule in the Second Circuit and the Southern District of New York.

Conflicting decisions have also arisen in the Tenth and Third Circuits. In *Grimes v. Crown Life Insurance Co.,* 857 F.2d 699 (10th Cir. 1988), the Tenth Circuit adopted the Second Circuit's rationale in *Levy* by holding that a District Court should have abstained from hearing a federal claim against an insurance company undergoing state liquidation proceedings. The Court reasoned that abstention is functionally equivalent to McCarran Act preemption in holding that the McCarran Act's deferral to state regulation of insurance includes state regulation of insurance insolvencies.

In *United States Automobile Ass'n v. Muir,* 792 F.2d 356 (3rd Cir. 1986), *cert. den.,* 107 S.Ct. 875 (1987), the Court analyzed a challenge by the United Services Automobile Association that a Pennsylvania statute which barred insurance companies from doing business in the state if they also owned a financial institution was unconstitutional. The District Court below abstained from the suit because the McCarran Act gave the states exclusive control over the regulation of insurance, citing *Levy* for the proposition that regulation of the business of insurance includes the liquidation of insolvent insurance companies. The Third Circuit reversed the decision to abstain but agreed with the lower court that regulation of an insolvent insurance company constitutes state

regulation of insurance under the primary purpose provisions of the McCarran Act. In so concluding, the Third Circuit employed the test announced by this Court in *Pireno*, only adding to the legal quagmire now engulfing McCarran Act jurisprudence.

The Second and Third Circuits have held that laws regulating insurance insolvency do regulate the business of insurance under *Pireno*. The Fourth Circuit has held directly the opposite. The Ninth Circuit has held that *Pireno* does not even apply, that such questions should be resolved under *National Securities*, and that the statutes regulating insurance insolvencies do not regulate the business of insurance. The Circuit Courts therefore have three different answers to the same question, one which only this Court can properly resolve.

C. Conflict Between the Federal Insolvency Statute and Idaho's Regulatory Scheme.

The Idaho Act is based upon the Insurers' Supervision, Rehabilitation and Liquidation Model Act drafted by the National Association of Insurance Commissioners ("NAIC") in 1969 and revised in 1979. The Model Act upon which Idaho's scheme is based and the provisions governing priority of payment are designed primarily to protect policyholders. Not coincidentally, the purpose of the McCarran Act itself is to protect policyholders on the premise that competition among insurers would minimize insurer insolvencies. *See*, Howard, *Defining the "Business of Insurance"*, 25 WILLAMETTE L.REV. 1 (1989). In addition, the object of state guaranty associations is to protect the individual policyholder ahead of all other claimants of an insolvent insurance company. Application of the FIS to insurance company liquidations

to elevate the claims of the federal government to a priority above those of policyholders transgresses the very reason for the state statutory schemes and the McCarran Act.

Idaho's regulatory scheme places primacy on policyholder claims. The FIS requires that claims of the federal government be paid ahead of anyone else. There is a direct conflict between the Idaho Act which was specifically tailored to federal legislation and the needs of the insurance industry, while the FIS is an ancient general application federal statute. This Court should not allow a general application federal statute to override the provisions of a narrowly tailored state insurance statute. The conflict between the two statutes begs for resolution.

II

THE ISSUES RAISED IN THIS PETITION ARE OF FAR-REACHING NATIONAL SIGNIFICANCE.

The questions at issue are of far-reaching national significance. The states have enacted comprehensive statutory schemes to govern the business of insurance companies and, for shareholders' protection, the business of insolvent insurance companies. Many of those states' statutes give priority to payment of policyholder claims from the assets of an insolvent carrier ahead of other claims. As evidenced by the number of cases analyzing this issue as set forth previously in this petition, many courts are being asked to address the regulatory problems associated with insolvent insurance companies. According to figures compiled by the National Association of Insurance Commissioners ("NAIC"), over 100 insurance company receiverships were pending in 27 states as of 1986.

See, American Bar Association, *Reference Handbook on Insurance Company Insolvency,* 621-41 (1986).

The irony of insurance company insolvencies is that the funds available are insufficient to pay the claims of those policyholders who provided the funds to operate the insurance company in the first place. Based upon model acts, state insurance codes, including Idaho's, give payment priority to policyholder claims so as to fulfill policyholder payment expectations to the maximum extent possible. The federal government's attempt to use the FIS to undercut the policies of the various states by seeking priority of payment could eventually undercut the entire basis upon which the state regulatory schemes are based, policyholder protection. If the Ninth Circuit's decision becomes a rule of law, the state regulatory program will be undercut as the federal government steps in front of policyholders to pay itself in full and consume all the assets which otherwise would have been available to pay policyholder claims.

This is a case of first impression in that this Court has not been asked to apply the McCarran Act to a state statute which purports on its face to regulate the business of insurance. Idaho Code Section 41-3342 is part of a comprehensive statutory scheme designed to regulate the business of insurance. The purpose of the Idaho Act is to regulate the insurance industry to avoid an insurer's insolvency by providing plenary powers to the Director of the Department of Insurance. The Ninth Circuit declined to examine the entire statutory scheme, but instead carved out a single section in applying its *National Securities* rationale and decided that that particular section did not deal with the relationship between the company and the policyholder.

The Ninth Circuit's decision also ignores the significance of the United States Bankruptcy Code, 11 U.S.C. Section 109(b)(2) wherein Congress specifically exempted liquidation of insurance companies from the Federal Bankruptcy Code. Congress would not have exempted insurance companies from liquidation under the Bankruptcy Code without anticipating that state regulation of that insurance activity would occur out of necessity. The states have traditionally regulated in this area in order to protect the interests of policyholders when the insurance company upon which they have relied and to which they have paid premiums fails to the detriment of those policyholders.

Only this Court has the ability to act in this significant and growing problem area. Direct conflicts between two federal statutes, between a federal statute and a state statute, and between different Circuit Courts, highlights the necessity to act immediately. Sufficient conflicting decisions have been rendered which are confusing to the insurance industry, state regulatory authorities, and to the detriment of insurance company policyholders around the country.

III

THE IDAHO ACT REGULATES THE BUSINESS OF INSURANCE FOR McCARRAN-FERGUSON ACT PURPOSES.

As previously established in this memorandum, this Court's McCarran Act decisions not involving the antitrust exemption define the "business of insurance" broadly to include the investigation and adjustment of claims, payment of loss, and other activities relating to the reliability of the insurance policy. The Ninth Circuit

properly relied upon *National Securities* in defining the "business of insurance." However, the Court incorrectly analyzed the Idaho statute and overlooked the practical aspects of insurance company liquidations in reaching that determination. The decision has already been criticized by one commentator who noted: "Only by elevating form over substance and disregarding policy decisions made by state legislators, however, was the Ninth Circuit able to conclude that Idaho's priority statute failed to satisfy this definition." Howard, *Defining the "Business of Insurance,"* 25 WILLAMETTE L.REV. at 86.

The Ninth Circuit focused upon the relationship between the insurer and the insured in determining that the priority scheme set forth in Idaho Code Section 41-3342 does not regulate the business of insurance. The Ninth Circuit broadly stated that "The statute deals with insurance companies that no longer are in the business of insurance," that "The insurer has ceased to exist," and finally, that in an insolvency situation the only relationship is between "debtor and creditor." *State of Idaho ex rel. Soward v. United States,* 858 F.2d at 452. Each of these statements ignores the reality of an insurance company in liquidation.

The Idaho Act does not provide, as was concluded by the Ninth Circuit, that an insurance company in liquidation has ceased to exist. To the contrary, an insurance company in liquidation continues to exist until fully liquidated. Idaho Code Section 41-3346. The company has rights, duties, and functions which continue during the liquidation, including risk protection. The company, through the liquidator, continues the payment of benefits under policy claims and continues to pay the debts of general creditors just as a day-to-day functioning insur-

ance company. Facts stipulated to in the District Court below demonstrate that the liquidator has paid claims in excess of $2,000,000.00.

In addition, the Ninth Circuit's decision ignores that a liquidator is statutorily charged with making every effort to continue the economic viability of segments of the business of an insurance company in liquidation in order to protect policyholder interests. For example, liquidators are authorized by statute to sell portions or blocks of the business to other economically viable insurance companies, thereby continuing the legally binding policy between policyholder and the new company. The Idaho statute contains detailed provisions for the appointment of a liquidator, for the recovery of preferences and other transfers, for offsets, for the disposition of assets and the compromise of claims, for the proof and allowance of claims, and for distribution of assets according to a scheme of priorities. Idaho Code Section 41-3321, *et seq.* These are all activities directly analogous to what the insurance company would be performing were it not in liquidation.

An additional question not addressed by the Ninth Circuit is the potential impact of federal tax liens on the primary state purpose of protecting policyholder interests. Under Section 809 of the Internal Revenue Code insolvent mutual companies subject to liquidation statutes may have differential earnings tax liabilities based upon surplus, rather than income. This section was enacted to equalize the tax liability between stock and mutual life insurance companies. The tax lien is based not upon income, but rather upon surplus. Under the Ninth Circuit's holding a federal tax lien would take precedence over all policyholder claims, leading to the

inevitable result that no monies for administration or policyholders would be paid prior to the payment of federal tax liens even though no income was earned upon which the tax lien would be based. This anomalous result should not be countenanced. It is directly contrary to the policy decision made by the Idaho legislature to provide first priority to premium-paying insurance policyholders.

Idaho's insurance insolvency system as enacted by the Director of the Department of Insurance has relied upon the decisions of this Court and the exemption from federal regulation set forth in the McCarran Act. Idaho has an integrated, unified system which continuously operates an insolvent insurance company until it is fully liquidated. The Director steps into the shoes of the insurer and enforces all of the insurer's rights and contracts. It is the insurance contract which was so crucial to this Court's decision in *National Securities*, which focused on "the relationship between insurer and insured," and "the reliability, interpretation and enforcement of insurance policies," which this Court has ruled are "the core of the business of insurance." *National Securities*, *id.* at 460. It is those aspects of the "business of insurance" with which the Director is concerned when he steps into the shoes of the insurance company and proceeds to carry out the insurance company's business.

CONCLUSION

For all the foregoing reasons, the Petition for Certiorari should be granted. The Court should remand to the Ninth Circuit with orders to affirm the judgment of the District Court below that the Respondent's claims herein are properly classified as Priority 5 claims and that the Director of the Department of Insurance has no obligation to pay Respondent's claims prior to the exhaustion of all funds on Priority 4 claims.

RESPECTFULLY SUBMITTED this 26th day of January, 1989.

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APPENDIX

APPENDIX A

(Filed September 7, 1988)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 87-4057
D.C. No.
CV 85-1501-HLR
OPINION

STATE OF IDAHO ex rel. WAYNE SOWARD, Director of the Department of Insurance; State of Idaho, as liquidator for PACIFIC INSURANCE ADMINISTRATORS, INC., and PACIFIC INSURANCE ADMINISTRATORS AGENCY, INC.,

Plaintiffs-Appellees,

v.

UNITED STATES OF AMERICA and the INTERNAL REVENUE SERVICE,

Defendants-Appellants.

Appeal from the United States District Court
for the District of Idaho
Harold L. Ryan, District Judge, Presiding

Argued and Submitted
February 1, 1988—Seattle, Washington

Filed September 7, 1988

Before: Betty B. Fletcher and William C. Canby, Jr.,* Circuit Judges, and Robert P. Aguilar, District Judge.**

Opinion by Judge Aguilar

SUMMARY

Insurance/Taxation/Bankruptcy

The court reversed a decision, vacated the judgment, and remanded the case holding that Idaho's Insurance Code does not regulate "the business of insurance" within the meaning of the McCarran-Ferguson Act and therefore the statute is not superseded by the Federal Insolvency Statute.

This case presents a conflict between the Idaho Insurance Code, § 41-3342, and the Federal Insolvency Statute (FIS), 31 U.S.C. § 3717. After encountering financial problems, two insurance companies surrender to the state's Insurance Director possession of the companies' assets and accepted liquidation. Appellant IRS submitted claims for federal taxes. Idaho's Insurance Code regulates insurance companies in the state from their inception to their liquidation. Section 41-3342 established the priority of distribution among claims. Class 5 of the priority scheme includes claims of the government. The liquidation proceeds were insufficient to pay the IRS's claims. The U.S. disputed the priority assigned to its claims, asserting that

*During the time this case was under submission, Judge Anderson died. Judge Canby was drawn to replace him and has reviewed the file and the briefs submitted in this case and has listened to the tape recording of oral argument.

**The Honorable Robert P. Aguilar, United States District Court Northern District of California, sitting by designation.

it was entitled to payment ahead of Class 4 claims under the FIS. The Director brought this interpleader action seeking a judgment that the U.S.'s claims are Class 5. The district court concluded that state law applys. It concluded that § 41-3342's framework for handling the priority of claims against insolvent insurers was regulation of the "business of insurance" within the meaning of the McCarran-Ferguson Act. Accordingly, the FIS did not apply.

[1] Under the McCarran-Ferguson Act, states regulate the "business of insurance." [2] Insurance companies are excluded from subjugation to proceedings under chapters 7 or 11 of the Bankruptcy Code. [3] Liquidation or reorganization is a responsibility retained by the states. [4] Yet that assignment is not a carte blanche for state's to legislate vis-a-vis insurance companies. [5] State authority to regulate its insolvent insurers is qualified by the requirement that the regulation must relate to the "business of insurance." [6] *Securities and Exchange Com'n v. National Securities,* 393 U.S. 453, construes the McCarran-Ferguson Act's "the business of insurance." [7] Statutes aimed at protecting or regulating the relationship between the insurance company and the policyholder are laws regulating the "business of insurance." [8] Under *National Securities,* section 41-3342 is *not* a law regulating the business of insurance. The only "business" being conducted is the liquidation of a corporation which happens to have been an insurance company. The Idaho statute is addressed to the relationship between debtor and creditor. [9] Furthermore, the priority scheme erected by the statute does not relate to the insurer's status as a "reliable insurer." [10] Of the two other cases cited by the parties, neither are necessary to decide this case.

COUNSEL

Steven W. Parks, Attorney Tax Division, Department of Justice, Washington, D.C., for the defendants-appellants.

Richard H. Greener, Clemons Coshow & Humphrey, Boise, Idaho, for the plaintiffs-appellees.

Carole J. Olson, Kansas City, Missouri, for the amicus National Association of Insurance Commissioners.

OPINION

AGUILAR, District Judge:

In this appeal the Internal Revenue Service challenges the district court's determination that an Idaho statute which establishes priority among creditors of insolvent insurance companies is a law "regulating the business of insurance" within the meaning of the McCarran-Ferguson Act and therefore supersedes the priority standard erected by the Federal Insolvency Statute, 31 U.S.C. § 3713. We reverse the decision of the district court, vacate the judgment, and remand the case for entry of judgment in favor of the United States of America.

FACTUAL BACKGROUND.

Pacific Insurance Administrators Agency, Inc., and Pacific Insurance Administrators, Inc., formerly engaged in the insurance business in Idaho. After encountering financial problems, the companies stipulated with the Director of the Idaho Department of Insurance ("Director") to cease doing business on February 23, 1983. The stipulation was filed in Ada County District Court on March 7,

1983. On February 25, 1983, the companies further stipulated with the Director to surrender to him possession of the assets of the companies and to accept liquidation of the companies with the Director acting as liquidator.

During the liquidation process, the Internal Revenue Service ("IRS"), on behalf of the United States, submitted claims for federal taxes, including penalties and interest, owed by the two companies. Amended claims stated that Pacific Insurance Administrators Agency, Inc., owed the United States $25,514.20, and that Pacific Insurance Administrators, Inc. owed the United States $88,482.26.[1]

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1. Each corporation had failed to pay proper amounts due with respect to withholding and FICA taxes, corporate income taxes, and federal unemployment taxes. The precise tabulations for the taxes due to the United States from each corporation are as follows:

	Pacific Ins. Adm. Agency, Inc.	Pacific Ins. Adm., Inc.
Withholding and FICA taxes:		
4th Quarter 1982		
Interest to 11-7-84		$ 35.54
Penalty to 11-7-84		155.60
1st quarter 1983	$ 1,996.68	4,386.85
Interest to 11-7-84	491.33	904.69
Penalty to 11-7-84	641.85	637.95
Corporate Income Taxes:		
1983 income tax	9,690.00	57,154.00
Interest to 11-7-84	1,726.06	9,059.59
Penalty to 11-7-84	1,698.26	4,572.32
1984 Income Tax	6,412.00	9,728.00
Interest to 11-7-84	225.77	353.31
Penalty to 11-7-84	512.24	777.56
Federal Unemployment Taxes:		
1983 unemployment tax	1,812.24	616.12
Interest to 11-7-84	164.35	54.38
Penalty to 11-7-84	143.42	45.26
TOTAL	$25,514.20	$88,482.26

The State of Idaho has laws that regulate insurance companies in the state from their inception to their liquidation. These laws are codified in the Idaho Insurers' Supervision, Rehabilitation and Liquidation Act, §§ 41-3301—41-3360 of the Idaho Code (hereafter referred to as the "Idaho Insurance Code" Section 41-3342 of the Idaho Insurance Code establishes the priority of distribution among claims against the estate of a liquidated insurer,[2] setting forth eight classes of claimants in descending order of priority. Class 5 of the priority scheme includes claims of "the federal or any state or local government."

As liquidator of the two companies, the Director determined that the claims of the United States ought to be handled under § 41-3342 of the Idaho Insurance Code. Pursuant to the statute, the Director relegated the claims to Class 5. The liquidation proceeds were insufficient to pay both Class 4 claims, which consisted principally of the claims of approximately one hundred fifty general creditors, and Class 5 claims. Because the statute provides that all Class 4 claims are to be paid prior to the payment of any Class 5 claims, the United States would not receive full satisfaction of the insolvents' obligations.

The United States disputed the priority assigned to its claims, asserting that it was entitled to payment ahead of Class 4 claims under the Federal Insolvency Statute ("FIS," 31 U.S.C. § 3713.[3] The FIS provides, *inter alia*,

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2. The text of § 41-3342 is reproduced as Exhibit A to this opinion.

3. The text of § 3713 states:

§ 3713. Priority of Government claims

(Continued on following page)

that claims of the United States shall be paid first whenever an insolvent person indebted to the federal government has made a voluntary assignment of property or has committed an "act of bankruptcy."

After obtaining an order from the Ada County District Court permitting him to set aside $90,927.17 to pay the claims of the United States, the Director as liquidator brought this interpleader action in the United States District Court for the District of Idaho ("District Court") seeking a judgment that the claims of the United States are Class 5 claims and that he has no personal liability under the FIS for payment of any claims ahead of those of the United States. The Director deposited $75,000 in the registry of the District Court. In its answer, the United States asserted priority for the taxes due under the FIS, requested judgment against the Director for the amount of unpaid taxes, and sought an order that the interpled funds be paid over to the United States.

Footnote continued—

(a)(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.

The case was submitted to the District Court on stipulated facts. On behalf of the United States, the IRS contended that the FIS governed the priority of the tax debts and, therefore, it was entitled to payment ahead of the Class 4 claimants. On behalf of the State of Idaho, the Director contended that state law controlled the priority of the federal government's claims due to provisions of the McCarran-Ferguson Act. Specifically, 15 U.S.C. § 1012(b) provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."[4]

The District Court concluded that state law does apply and that § 41-3342 governs the priority of the tax debts due to the United States. The court reasoned that § 41-3342 is part of the Idaho Insurance Code, a general regulatory scheme in the State of Idaho which regulates the state's insurance industry "from cradle to grave."

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4. In relevant part, the McCarran-Ferguson Act states as follows:

§ 1011. Declaration of Policy

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) State regulation

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(Continued on following page)

In light of this analysis, the District Court concluded that § 41-3342's framework for handling the priority of claims against insolvent insurers was regulation of the "business of insurance" within the meaning of the McCarran-Ferguson Act; accordingly, the FIS did not apply. The IRS now appeals.

DISCUSSION.

(A) *Standard of Review*:

Whether the Idaho statute in question is a law regulating the business of insurance within the meaning of the McCarran-Ferguson Act is a question of law. As such, it is reviewed *de novo*. *Keith v. Volpe*, 833 F.2d 850, 854 (9th Cir. 1987) ("[A]ny elements of legal analysis and statutory interpretation which figure in the district court's decision are reviewable de novo"), *quoting Hall v. Bolger*, 768 F.2d 1148, 1150 (9th Cir. 1985).

(B) *Overview of the Issue*:

This case presents a clear conflict between the Idaho Insurance Code, § 41-3342, and the FIS, 31 U.S.C. § 3713.

Footnote continued—

(b) Federal regulation

No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. § 41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

The scope of the conflict warrants clarification. The IRS argues from two significantly different positions in this appeal. On the one hand, the IRS advances the narrow proposition that its claims simply have "priority ahead of that accorded the Class 4 claimants." *Excerpt of Record* ("ER") at 17 (*Stipulation of Facts* at 3, filed June 30, 1986). *See also Brief for Appellants* at 25 ("[T]he priority dispute here concerns only the claims of the United States and those of Class 4 creditors, the vast majority of which are merely general creditors.") If we were to decide the appeal on this narrow basis, we would not reach the issue of whether payment of claims in Classes 1 through 3 properly precedes satisfaction of the insolvents' obligations to the United States.

On the other hand, throughout its brief and oral argument, the IRS advanced the view that it is "inconceivable that Congress could have intended in enacting the McCarran-Ferguson Act to allow states to dictate the priority of federal claims on the insolvency of an insurance company." *Id.* at 8. Thus, not merely Class 4 claims but all claims of any nature would be subordinated to the federal government's claim because "[t]he McCarran-Ferguson Act has no effect on the Federal Insolvency Statute." *Id.* at 6.

Although the IRS' characterization of this case as a narrowly framed dispute between general creditors (in Class 4) and the United States (in Class 5) is plausible, we find that the issue on appeal must be stated more broadly. The First Amended Complaint filed on December 31, 1985, seeks a determination whether the IRS' claim properly is treated as a Class 5 claim "or as a Class 1 claim pursuant to 31 U.S.C. § 3713." In other

words, the relief sought raises the issue whether the FIS supersedes § 41-3342 in its entirety, not simply whether, within the scheme Idaho has erected by § 41-3342, the United States deserves a higher peg on the priority chart than general creditors. Consistent with this request for relief, the District Court concluded that "[b]y virtue of the application of the McCarran-Ferguson Act. . . 31 U.S.C. § 3713 does not supersede Idaho [Insurance] Code § 41-3342." ER at 12 (Order of District Court, filed May 4, 1987). Thus, in resolving the question of the IRS' ability to obtain satisfaction of the insolvents' outstanding tax obligations, we must determine whether the entire priority arrangement of Idaho Insurance Code § 41-3342 supersedes the FIS. In turn, the question of which statute controls hinges on whether § 41-3342 is a law regulating the business of insurance within the contemplation of the McCarran-Ferguson Act.

(C) *The McCarran-Ferguson Act*:

In 1869, the Supreme Court ruled that the issuance of "a policy of insurance is not a transaction of commerce." *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 183 (1869). Prior to the enactment of the McCarran-Ferguson Act, Congress reflected its agreement with the ruling in *Paul* by leaving the regulation of insurance transactions entirely to the States. *See Securities and Exchange Com'n v. National Securities, Inc.*, 393 U.S. 453, 458-59 (1969) (discussing legislative history of McCarran-Ferguson Act). This prevailing view was abruptly shaken in 1944 when the Supreme Court decided *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, wherein the Court concluded that insurance transactions were "commerce" sub-

ject to federal regulation—in particular the federal antitrust laws. *See* 322 U.S. at 560-62.[5]

Even before the ink had dried on the *South-Eastern Underwriters* opinion, Congress moved to protect insurance companies from federal regulation. Declaring that "the continued regulation and taxation by the several States of the business of insurance is in the public interest," 15 U.S.C. § 1011, Congress passed the McCarran-Ferguson Act. The intent of Congress is evinced in the following passage of the law's legislative history:

> Inevitable uncertainties which followed the handing down of the decision in the *Southeastern* [*sic*] *Underwriters Association* case, with respect to the constitutionality of State laws, have raised questions in the minds of insurance executives, State insurance officials, and others as to the validity of State tax laws as well as State regulatory provisions; thus making desirable legislation by the Congress to stabilize the general situation.
>
> . . .
>
> The purpose of the bill is twofold: (1) To declare that the continued regulation and taxation by the several States of the business of insurance is in the public interest; and (2) to assure a more adequate regulation of this business in the States by suspending the application of the Sherman and Clayton Acts. . . .

H.R. Rep. No. 143, 79th Cong., 1st Sess. 2-3, *reprinted in* 1945 U.S. Code Cong. & Ad. News 670, 671-72. *Accord* S. Rep. No. 20, 79th Cong., 1st Sess. 1-2 (1945).

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5. A House Report later referred to *South-Eastern Underwriters* as a "precedent-smashing decision." H.R. Rep. No. 143, 79th Cong., 1st Sess. 2-3, *reprinted in* 1945 U.S. Code Cong. & Ad. News 670, 671.

[1] Given this specific legislative intent, both Congress and the courts have declared that the McCarran-Ferguson Act was not intended to open new areas of regulatory discretion to the States, but rather to return the realm of insurance transactions to the *status quo ante*. Hence, the House Report states that "[i]t is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern* [*sic*] *Underwriters Association* case." H.R. Rep. No. 143, 79th Cong., 1st Sess. 3 (1945), *reprinted in* 1945 U.S. Code Cong. & Ad. News 671. Drawing upon the foregoing language, the Supreme Court has concluded that the McCarran-Ferguson Act "was an attempt to turn back the clock, to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation." *National Securities*, 393 U.S. at 459. Hence the law provides that states alone may regulate the "business of insurance." Over the years, the challenge for courts has been faithfully to distinguish this activity from the regulation of the business of insurers.

(D) *The Regulation of Insolvent Insurance Companies*:

[2] For at least this century, Congress has excluded insurance companies from the provisions of the federal bankruptcy laws. Insurance companies, municipalities, railroads, banks, and building and loan associations were not subject to the Bankruptcy Act of July 1, 1898. 11 U.S.C. § 22(a) (West 1979). The new Bankruptcy Code enacted in 1978 continues the tradition by excluding insurance companies (among others) from subjugation to

proceedings under chapters 7 or 11 of the Bankruptcy Code. 11 U.S.C. § 109 (West 1979 § Supp. 1988). As a result of this historical exclusion, courts have maintained that the proper procedures and rules for "dismemberment" of insurance companies "is a question as to which the Supreme Court of [each] state will speak with ultimate authority." *Clark v. Williard,* 292 U.S. 112, 123 (1934) (Cardozo, J.).

[3] Thus, federal courts have been reluctant to intrude in state proceedings, adhering to the view that whether it be liquidation or reorganization, the handling of the affairs of insolvent insurance companies is a responsibility retained by the states. *See, e.g., Motlow v. Southern Holding & Securities Corp.,* 95 F.2d 721, 725-26 (8th Cir.), *cert. denied,* 305 U.S. 609 (1938) (like any other corporation, liquidation of insurance companies is best performed by a single entity possessing title, custody, and control of all assets; vis-a-vis insurers, Congress has left that authority in the states); *Levy v. Lewis,* 635 F.2d 960, 963-64 (2d Cir. 1980) (quoting *Motlow* and stating that "the administrative and judicial scheme erected by New York to regulate insurance companies, including that part enabling the institution and implementation of liquidation proceedings, operates pursuant to an express federal policy of noninterference in insurance matters); *Universal Marine Ins. Co., Ltd. v. Beacon Ins. Co.,* 768 F.2d 84, 88 (4th Cir. 1985) ("Reorganization of insolvent insurance companies is a matter of state law and is handled through insolvency proceedings in state court."); *Blackhawk Heating & Plumbing Co., Inc. v. Geeslin,* 530 F.2d 154, 159 (7th Cir. 1976) ("The states have a paramount interest in seeing that liquidation proceedings conducted by court-appointed liquidators and overseen by their courts are free from [federal] interference.")

[4] Notwithstanding the normally preemptive labyrinth that is the Bankruptcy Code, then, Congress has assigned the States the virtually autonomous role of ministering to their own insolvent insurance companies. Yet that assignment is not a *carte blanche* for state's to legislate vis-a-vis insurance companies. At all times, States are constrained by the Constitution, particularly with respect to areas of authority conferred on Congress by the People through the Constitution. For example, as a result of the Commerce Clause, Congress has a mandate to enhance the general welfare of the nation by the regulation and promotion of interstate commerce. The assignment of this responsibility to the States is possible, *New England Power Co. v. New Hampshire,* 455 U.S. 331, 339-40 (1982) ("It is indeed well settled that Congress may use its powers under the Commerce Clause to '[confer] upon the States an ability to restrict the flow of interstate commerce that they would not otherwise enjoy,' "), *quoting Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 44 (1980), but, as in the case of the McCarran-Ferguson Act, such a delegation is to be "narrowly construed in the face of valid federal regulatory interests." *Cochran v. Paco Inc.*, 606 F.2d 460, 467 (5th Cir. 1979); *accord United States v. Title Ins. Rating Bureau of Arizona,* 700 F.2d 1247, 1249 (9th Cir. 1983) (the McCarran-Ferguson Act "is to be narrowly construed"), *cert. denied,* 467 U.S. 1240.

[5] The enforcement of tax obligations pursuant to Article I § 8 of the Constitution represents a similar type of valid and compelling federal regulatory interest that militates against the diminution or supersession of federal authority. The fact that the FIS has been the law of the land for nearly two hundred years testifies to the primacy and constancy of this interest. *See* Act of March 3, 1797,

ch. 20, 1 Stat. 512, 515, Sec. 5 (4th Cong., 2d Sess.), amended by Act of March 2, 1799, ch. 22, 1 Stat. 627, 676, Sec. 65 (5th Cong., 3d Sess.).[6] For historical background, see *United States v. Emory*, 314 U.S. 423, 426-28 (1941) ("The purpose of this section is 'to secure adequate public revenues to sustain the public burden' [citation omitted], and it is to be construed liberally in order to effectuate that purpose (citation omitted].") Quite appropriately, then, Congress has explicitly delimited the scope of state prerogatives with respect to the regulation of insurance. In particular, state authority to regulate its insolvent insurers free from preemption by general federal statutes necessarily is qualified by the requirement that the regulation must relate to the "business of insurance."

(E) *Construction of the Phrase "Business of Insurance":*

(i) *The Securities and Exchange Com'n v. National Securities Case.*

[6] The seminal case construing the McCarran-Ferguson Act's phrase, the "business of insurance," is *Securities and Exchange Com'n v. National Securities*, 393 U.S. 453 (1969). In that case, the Court confronted an Arizona statute aimed at protecting stockholders in insurance companies. A panel of this court had found that the statute superseded the federal securities laws (because it regulated the "business of insurance" within the meaning of the

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6. In 1982, Congress amended the FIS (formerly R.S. 3466 31 U.S.C. § 191) at 31 U.S.C. § 3713. Act of September 13, 1982, Pub. L. No. 97-258, 96 Stat. 972, Sec. 1. No substantive changes were made in the statute. Congress merely amended the language of the statute to reflect contemporary usage. *See* H.R. Rep. No. 97-651, 97th Cong. 2d Sess. 1, 3-4 130-35 *reprinted in* 1982 U.S. Code Cong. & Ad. News 1895, 1896-1898, 2024-29.

McCarran-Ferguson Act), and hence immunized conduct that was allegedly violative of the anti-fraud provisions of the Securities Exchange Act of 1934.

[7] The key to the Supreme Court's analysis in *National Securities* was the Court's construction of the term "business of insurance." At the outset, the Court noted that the legislative history "shed[s] little light on the meaning of the words 'business of insurance'." 393 U.S. 459. Nevertheless, the Court found it "relatively clear what problems Congress was dealing with." *Id.* After reviewing the intent of Congress in passing the law, the Court went on to state:

> Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not "commerce." The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."

Id. at 460.

Applying this reasoning to the statute before it, the Court in *National Securities* found the Arizona statute outside the scope of the McCarran-Ferguson Act. The Ari-

zona statute did not regulate the "insurance" relationship, but rather the relationship between a stockholder and the company in which the investor held stock. Such a law, said the Court, "is not insurance regulation, but securities regulation." *Id.* To the objection that the statute applied only to insurance companies, the Court tersely replied that "mere matters of form need not detain us," *id.*, and went on to state:

> The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

Id.

(ii) *Application of National Securities to this Case*:

[8] Application of the holding and reasoning of *National Securities* to this case leads to the conclusion that Idaho Insurance Code § 41-3342 is *not* a law regulating the business of insurance. To begin with, the statute deals with insurance companies that no longer are in the business of insurance. The only "business" being conducted is the liquidation of a corporation which happens to have been an insurance company. Hence, the scope of the net cast by the statute is wholly unrelated to the relationship between insurer and insured. The insurer has ceased to exist. The only relationship is between the insureds and the government official charged with overseeing the liquidation of the insolvents. Whereas the Court in *National Securities* found that in legislating the McCarran-Ferguson Act Congress focused on the relationship between insurer and insured, 393 U.S. at 460, the Idaho statute speaks to

an entirely different concern in this context: the relationship between debtor and creditor. The relationship regulated by § 41-3342 that is at issue in this case is between the liquidated assets of corporations and the claims of various creditors.

[9] Furthermore, only by a great stretch of imagination can it be said that the priority scheme erected by § 41-3342 relates closely to the insurer's status as a "reliable insurer[]." *National Securities*, 393 U.S. at 460. Once rendered insolvent and placed in the hands of a liquidator, an insurance company no longer is involved in risk protection, nor is there anything that a liquidator could do to make the defunct entity a reliable insurer. In such a situation, the state is no longer regulating the traditional business of insurance, and, thus, has exceeded the boundaries within which the McCarran-Ferguson Act frees it from preemption by general federal statutes. This conclusion is buttressed by the admonition, drawn from the opinion in *National Securities*, that the exemption "is for the 'business of insurance,' not the 'business of insurers.'" *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 (1979), *citing National Securities*, 393 U.S. at 459-60.

On the basis of the *National Securities* case, it is tolerably clear that Idaho Insurance Code § 41-3342 is not a law regulating "the business of insurance" within the meaning of the McCarran-Ferguson Act and therefore the statute is superseded by the FIS.

(iii) *A Second Level of Analysis*:

In assessing the meaning of "business of insurance" within the context of the McCarran-Ferguson Act, the parties devote much attention to two Supreme Court cases

decided after *National Securities*. The first case is *Group Life & Health Ins. Co. v. Royal Drug Co., Inc.*, 440 U.S. 205 (1979), a dispute involving a price-fixing scheme in Texas between the Blue Shield health plan and pharmacies providing drugs to Blue Shield policyholders. The second case is *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), which involved an insurance company's use of an independent source to evaluate claims made for chiropractic treatments. The relevance of both cases is that in each the Supreme Court used a three-prong test to ascertain the meaning of the phrase "business of insurance."

[10] Although ostensibly appearing to speak to the precise issue raised here, neither *Royal Drug* nor *Pireno* are necessary to decide this case. Both cases are refinements of the seminal analysis of *National Securities* tailored to address activities of insurance companies that would implicate the antitrust laws in the absence of the McCarran-Ferguson Act.

In light of the insurers' insolvency and liquidation, there is no activity of an insurance company to be assessed. The companies have ceased to exist. This is underscored by the parties' omission of discussion regarding the nature of the claims of the general creditors in Class 4. For example, in what capacity did the insurers incur the debts owed to each general creditor? The reason that the parties properly ignore this issue is because the nature of the insurance companies' "activities" is a moot question. Their activities have ceased just as they themselves have ceased to exist—leaving behind a finite pool of assets which the State of Idaho seeks to distribute according to its own plan. This is distinct from any "business of insurance" situation envisioned by the McCarran-Ferguson Act.

The second reason why the two cases need not be reached is that the tripartite analysis developed in *Royal Drug* and followed in *Pireno* focused on contracts entered into by insurers directly or indirectly implicating policyholders. Idaho cannot offer a colorable argument to the effect that the general creditors in Class 4 or that the IRS' claims in Class 5 implicate policyholders. By the time these classes of claims are reached, all policyholders' claims will have been satisfied. Even with respect to policyholders in Class 3, their status is most aptly described as "debtors" because the policy relationship has been terminated. Finally, claims in Classes 1 and 2 obviously are unrelated to the insurer-insured relationship. Consequently, this case does not even rise to the level of doubt present in either *Royal Drug* or *Pireno*. *National Securities* and the legislative history alone are enough to decide this case without the three prongs of *Royal Drug*.

(iv) *The Application of the Royal Drug Test*:

If we were to examine the facts here in the light of the factors enumerated in *Royal Drug*, it is clear that § 41-3342 would not pass muster as a law regulating the business of insurance. *Royal Drug* identified three characteristics of the business of insurance that Congress intended to exempt through the McCarran-Ferguson Act. These characteristics were summarized in *Pireno* as follows:

> [F]irst, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.

458 U.S. at 129.

Idaho Insurance Code § 41-3342 does not satisfy any of the tests articulated by the Supreme Court to determine whether a particular practice falls within the ambit of the "business of insurance." The statute's assignment of priority to some creditors as against governmental entities does not transfer or spread policyholder risk. In clarifying the content of the first prong of the *Royal Drug* test, the Supreme Court has stated that the "spreading" and "underwriting" of policyholder's risk denoted in *Royal Drug* relates to the "transfer of risk characteristic of insurance." *Pireno*, 458 U.S. at 130. As explained in *Pireno*, that risk is transferred "by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." *Id.*[7] Consequently, the statute does not speak to "policyholder risk" as defined in Supreme Court jurisprudence.

Nor does the statute play an integral role in the insurer-insured policy relationship for, as stated above, the insurer has ceased to exist by the time this statute comes into play. What the statute does address is the relationship between those left in the lurch by the expiration of the insurer. As among these creditors, the

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7. By analogy, the Supreme Court squarely has rejected the argument offered by Idaho that payment of unsettled claims by means of assets from the insolvents' estates is a form of risk spreading. In *Pireno* the Court observed:

> Petitioner's argument contains the unspoken premise that the transfer of risk from an insured to his insurer actually takes place not when the contract between those parties is completed, but rather only when the insured's claim is settled. This premise is contrary to the fundamental principle of insurance that the insurance policy defines the scope of risk assumed by the insurer from the insured. [citations omitted]

458 U.S. at 131.

statute purports to establish priorities which relegate government agencies, in particular, taxing authorities, to a subordinated position in terms of the collection of the debt owed by the insured.

Finally, the statute is not limited in effect to entities solely within the insurance industry. Creditors of all varieties have their claims assigned priorities by the statute, including the local, state, and federal governments. Thus, § 41-3342 fails to satisfy even a single prong of the test developed by the Supreme Court to ascertain whether a given practice or contract can be considered to regulate the business of insurance.

The United States Court of Appeals for the Fourth Circuit recently reached this same conclusion with respect to a Maryland statute purporting to assign less than foremost priority to claims of the United States against the estate of an insolvent insurance company. In *Gordon v. United States Department of the Treasury*, 846 F.2d 272 (4th Cir. 1988) (per curiam), the Fourth Circuit adopted with only modest elaboration the opinion of the district court concluding that none of the *Royal Drug* factors was met by a Maryland claim-priority statute. *See* 668 F.Supp. 483, 490-91 (D. Md. 1987); *see also Langdeau v. United States*, 363 S.W.2d 327, 331 (Tex. Civ.App. 1962) ("This is not a regulation of the insurance business; it is a priority established for a class of creditors of an insurance company.") The decision in *Gordon* simply bolsters our view of this case.

(F) *Clarification of Remaining Issues*:

This section briefly addresses other objections and points raised by the State of Idaho.

One flaw that ran throughout the State of Idaho's brief and oral argument is its insistence on viewing the statute as a whole. Idaho believes that we should not look only at § 41-3342 to decide the case, but should examine the entire statutory scheme erected by Idaho Insurance Code. There are several problems with this suggestion, the most obvious of which is that it begs the question. When considered as a whole, obviously the statute does seek to regulate the business of insurance; but the question is whether this specific provision constitutes the type of regulation that Congress sought to protect from indirect federal preemption by passing the McCarran-Ferguson Act. If Idaho's approach was correct, the Supreme Court could not have decided *National Securities* as it did, because the Court would have had to accept the Arizona provision as part of a statute which undeniably regulated the business of insurance.

The second point raised by Idaho is that *Royal Drug* and *Pireno* are factually distinct from this case. As indicated above, we agree with this assessment. Both *Royal Drug* and *Pireno* dealt with insurance company activities implicating the antitrust laws, whereas this case involves a state statute and a state liquidator acting in contravention of a federal debt statute. Whereas Idaho is correct that the contracts and insurer-insured relationships involved in *Royal Drug* and *Pireno* distinguish them from this case, this only serves to underscore the implausibility of the State's position. The point of all three of the aforementioned Supreme Court cases is that the McCarran-Ferguson Act sought to exempt laws which regulate actions of insurance companies involving insurance policies. The insurance contract is truly at center

stage. Yet, at base § 41-3342 does not speak to insurance contracts; instead, it instructs a liquidator how to act when distributing the assets of a corporation that once sold insurance.

Finally, Idaho argues that the elements necessary to trigger the application of the FIS are not present. The State's argument is frivolous. The State Director of Insurance filed this interpleader action precisely because the two companies lacked funds sufficient to satisfy their outstanding obligations. This satisfies subpart (a)(1)(B) of the FIS which states that the United States shall be paid first when a person is insolvent and his estate, in the custody of an administrator, is inadequate to satisfy all outstanding debts. In addition, subpart (a)(1)(A)(i) of the statute is satisfied by the companies' stipulation acknowledging insolvency and voluntarily transferring their assets to the Director for purposes of liquidation. The FIS is clearly implicated.

CONCLUSION.

Idaho Insurance Code § 41-3342 is not a law regulating the "business of insurance" within the contemplation of the McCarran-Ferguson Act. Therefore, the Federal Insolvency Statute controls and the United States is entitled to receive full payment of the insolvents' obligations prior to satisfaction of the obligations of other creditors. We reverse the District Court's decision, vacate the judgment, and remand the case for distribution of the remaining assets in a fashion consistent with the FIS, 31 U.S.C. § 3713.

REVERSED AND REMANDED.

EXHIBIT A

Idaho Code Section 41-3342:

41-3342. Priority of distribution.—The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims as herein set forth. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(1) Class 1. The costs and expenses of administration, including, but not limited to, the following:

(a) The actual and necessary costs of preserving or recovering the assets of the insurer; (b) Compensation for all services rendered in the liquidation; (c) Any necessary filing fees; (d) The fees and mileage payable to witnesses; (e) Reasonable attorney's fees; and (f) The reasonable expenses of a guaranty association or foreign guaranty association in handling claims.

(2) Class 2. Debts due to employees for services performed and benefits accrued to the extent that they do not exceed one thousand dollars ($1,000) and represent payment for services performed within one (1) year before the commencing of delinquency proceedings. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority which may be authorized by law as to wages or compensation of employees.

(3) Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property which are not under policies, and all claims of a guaranty association or foreign guarantee association. All claims under life and annuity policies, whether for death proceeds, annuity proceeds, or investment values shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to his employee shall be treated as a gratuity.

(4) Class 4. Claims under nonassessable policies for unearned premium of [*sic.*] other premium refunds and claims of general creditors.

(5) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be postponed to the class of claims under subsection (8) of this section.

(6) Class 6. Claims filed late or any other claims other than claims under subsections (7) and (8) of this section.

(7) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in accordance with law.

(8) Class 8. The claims of shareholders or other owners.

APPENDIX B

(Filed May 4, 1987)

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF
IDAHO

CIVIL NO. 85-1501

STATE OF IDAHO EX REL.
WAYNE L. SOWARD, et al.,
Plaintiffs,
v.
UNITED STATES OF AMERICA, THE
INTERNAL REVENUE
SERVICE, et al.,
Defendants.

ORDER

I. INTRODUCTION

This is an interpleader action brought by the State of Idaho on behalf of Wayne Soward, who is the Director of the Department of Insurance for the State of Idaho, and who has been named the liquidator for Pacific Insurance Agency, Inc., and Pacific Insurance Administrators Agency, Inc. The question presented in this action is whether the claims of the United States Internal Revenue

Service (IRS) receive their priority status in the underlying liquidation proceeding pursuant to Idaho Code § 41-3342 or 31 U.S.C. § 3713. A secondary issue is whether, if 31 U.S.C. § 3713 applies, post-assignment tax, interest and penalties may be included in the claim of the IRS. This case has been submitted to the court on stipulated facts.

The liquidation proceeding is being conducted in the Fourth Judicial District of the State of Idaho. Numerous individuals and entities have made claims in the liquidation proceeding. The IRS filed a claim on May 31, 1983, which has been amended several times to include additional taxes, interest and penalties. Idaho Code § 41-3342 establishes a priority of payment to classes of claimants. Federal, state and local government claims are relegated to a class five status. Costs and expenses of administration, debts due to employees, claims made by insureds, claims for premium refunds and claims of general creditors are paid before claims brought by governmental entities. Title 31, U.S.C. § 3713 provides that claims of the U.S. shall be paid first when a person is indebted to the government, is insolvent, and makes a voluntary assignment of property without enough property to pay all debts, the property is attached or an act of bankruptcy is committed.

The IRS asserts in the underlying action that 31 U.S.C. § 3713 mandates that the IRS claim be paid before any other claims. The State of Idaho asserts that the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.*, prevents the federal priority statute, 31 U.S.C. § 3713, from superseding state law and that 31 U.S.C. § 3713 is not applicable to this case in any event.

II. ANALYSIS

A. *Idaho Insurance Code, Title 14, Chapters 1-43 of Idaho Code*

Chapter 33 of Title 41 of the Idaho Code is entitled "insurers' supervision, rehabilitation and liquidation." This Act was adopted from a model act drafted by the National Association of Insurance Commissioners, that body partially responsible for the McCarran-Ferguson Act to be discussed below. Idaho Code § 41-3301(4) states that the purpose of the Act is to protect the interest of insureds, claimants, creditors and the public generally through early detection of a potentially dangerous condition of an insurer, improved methods of rehabilitation, enhanced efficiency in liquidation, equitable apportionment, increased jurisdiction and regulation of the insurance business as a whole.

The Department of Insurance has plenary power to intervene in the affairs of an insurer to avoid insolvency or to liquidate in the event insolvency is unavoidable. Idaho Code § 41-3309. The insurer and its agents are directed to fully cooperate with the director of insurance. Idaho Code § 41-3306. The stated purpose of any rehabilitation or liquidation is the protection of the rights of all interested parties.

Idaho Code § 41-3342 outlines the priority of distribution in the event of liquidation. Claimants are placed into classes and prioritized. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. Class one is costs and expenses of administration. Class two is debts due to employees for services performed and benefits accrued. Class three includes all claims

under policies for losses incurred. Class four includes claims under non-assessable policies for unearned premium or other premium refunds and claims of general creditors. Class five includes claims of the federal or any state or local government. Class six refers to late claims. Class seven relates to surplus or contribution notes, or similar obligations, and the premium refunds on assessable policies. Class eight refers to claims of shareholders or owners.

In the underlying liquidation proceedings, the claims of the IRS have been given a class five status.

B. *Title 31, U.S.C. § 3713*

Title 31, U.S.C. § 3713 is entitled "priority of government claims." The statute provides that a claim of the United States Government shall be paid first when a person indebted to the government is insolvent *and* the debtor without enough property to pay all debts makes a voluntary assignment of property or property of the debtor, if absent, is attached or an act of bankruptcy is committed. The statute expressly does not apply to a case under Title 11 in bankruptcy.

The IRS claims that 31 U.S.C. § 3713 supersedes Section 41-3342 of the Idaho Code and elevates the IRS claim in the state insurance proceeding from a class five status.

C. *McCarran-Ferguson Act, Title 15, U.S.C. § 10011, et seq.*

Prior to 1944, the states and the federal courts had recognized states' regulation in the area of insurance. However, in *United States v. Southeastern Underwriters Association*, 322 U.S. 533 (1944), the Supreme Court held

that insurance transactions were subject to federal regulation. Soon thereafter, Congress enacted the McCarran-Ferguson Act to reverse the Supreme Court's decision and place back in the hands of the states regulation of the insurance industry.

The declaration of policy in the McCarran-Ferguson Act, Section 1011, declares that the continued regulation and taxation by the states of the business of insurance is in the public interest and that silence on the part of Congress shall not be construed to impose any barrier to the states. Section 1012(a) states that the business of insurance shall be subject to the laws of the states which relate to the regulation or taxation of such business. Section 1012(b) states that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance."

The State of Idaho argues that the McCarren-Ferguson Act applies to this case such that the Idaho priority statute is determinative.

D. *Effect of McCarran-Ferguson*

The McCarran-Ferguson Act is a specific act which exempts the business of insurance from federal legislation unless that federal legislation specifically announces that it supersedes McCarran-Ferguson. Title 31 U.S.C. § 3713 is a statute of general application which makes no specific statement that it supersedes McCarran-Ferguson or is applicable to the business of insurance. Therefore, consistent with 15 U.S.C. § 1012(b), this court cannot con-

strue that Act of Congress, 31 U.S.C. § 3713, to invalidate, impair or supersede Idaho Code § 41-3342 since 31 U.S.C. § 3713 does not specifically relate to the business of insurance, provided that the court finds (1) 31 U.S.C. § 3713 will invalidate, impair or supersede Idaho Code § 41-3342 and (2) that Idaho Code § 41-3342 is enacted for the purpose of regulating the business of insurance.

It is beyond cavil that the application of 31 U.S.C. § 3713 to the federal government's claim in the liquidation proceeding underlying this litigation would invalidate, impair and supersede a portion of the state's priority statute by causing the federal government's claim to be paid first, potentially impairing the ability of the state to pay the claims in the other classes designated in the priority statute. The state law would be impaired.

The most contested issue in this litigation is whether the priority scheme in Idaho Code § 41-3342 relating to the liquidation of insurance companies is a state statute enacted for the purpose of regulating the "business of insurance." The Insurer's Supervision, Rehabilitation, and Liquidation Act, of which Idaho Code § 41-3342 is a part, comprises a portion of the general regulatory scheme in the State of Idaho over the insurance industry. The stated purpose of the Act is to protect the interest of insureds, claimants, creditors, and the public generally through regulating the insurance business with law relating to delinquency procedures and substantive rules over the entire insurance industry. See Idaho Code § 41-3301(f). The state's regulatory scheme relates to the entire life of the particular insurance business, from the birth of a new insurance business through its activities and productive years and through the business's dissolution and death. The right of the state to regulate and control the insurance

company should include the right to manage its dissolution and liquidation as part of the overall regulatory scheme.

This court is in accord with the court in *Washburn v. Corcoran*, 643 F.Supp. 554 (S.D.N.Y. 1986). Therein, the court specifically found that the winding up of the affairs of insurance companies is part and parcel of the state act providing for a complex administrative and judicial system for regulating and liquidating domestic insurance companies. The court found that the laws providing for the rehabilitation, liquidation or dissolution of insurance companies are laws regulating the business of insurance. *Id.* at 556. This court holds that Idaho Code § 41-3342 is not superseded by 31 U.S.C. § 3713 and that the priority status of the claims of the United States in the underlying liquidation proceeding is determined by Idaho Code § 41-3342.

The other issues raised by the parties, whether 31 U.S.C. § 3713 is applicable to the liquidation proceedings by its very terms and whether, if 31 U.S.C. § 3713 applies, post-assignment tax, interest and penalties may be included in the claim of the IRS, need not be determined by the court. The court's determination that final distribution in the liquidation proceedings shall be in accordance with the priorities established by Idaho Code § 41-3342 by virtue of application of the McCarran-Ferguson Act, renders discussion of the remaining issues unnecessary.

III. ORDER

Based upon the foregoing and the court being fully advised in the premises,

IT IS HEREBY ORDERED, DECLARED AND ADJUDGED that the claims of the United States in the under-

lying liquidation proceeding receive their priority status, in that liquidation proceeding, pursuant to Idaho Code § 41-3342. By virtue of the application of the McCarran-Ferguson Act, as noted above, 31 U.S.C. § 3713 does not supersede Idaho Code § 41-3342.

DATED this 4 day of May, 1987.

/s/ Harold L. Ryan

Harold L. Ryan
United States District Judge

APPENDIX C

(Filed October 31, 1988)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 87-4057

STATE OF IDAHO ex rel. WAYNE SOWARD, Director of the Department of Insurance; State of Idaho, as liquidator for PACIFIC INSURANCE ADMINISTRATORS, INC., and PACIFIC INSURANCE ADMINISTRATORS AGENCY, INC.,

Plaintiffs,

v.

UNITED STATES OF AMERICA and the INTERNAL REVENUE SERVICE,

Defendants.

ORDER

Before: FLETCHER, CANBY, Circuit Judges, and AGUILAR*

The petition for rehearing is denied.

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*The Honorable Robert P. Aguilar, United States District Judge for the Northern District of California, sitting by designation.

APPENDIX D

THE McCARRAN ACT

§ 1011. Declaration of policy

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

Mar. 9, 1945, c. 20, § 1, 59 Stat. 33.

§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

Mar. 9, 1945, c. 20, § 2, 59 Stat. 34; July 25, 1947, c. 326, 61 Stat. 448.

APPENDIX E

PRIORITY OF GOVERNMENT CLAIMS

§ 3713. Priority of Government claims

(a)(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.

(Pub.L. 97-258, Sept. 13, 1982, 96 Stat. 972.)

APPENDIX F

CHAPTER 33

INSURERS SUPERVISION, REHABILITATION AND LIQUIDATION

SECTION.

41-3301. Construction and purpose.
41-3302. Persons covered.
41-3303. Definitions.
41-3304. Jurisdiction and venue.
41-3305. Injunctions and orders.
41-3306. Cooperations of officers, owners, and employees.
41-3307. Bonds.
41-3308. Continuation of delinquency proceedings.
41-3309. Director's summary orders and supervision proceedings.
41-3310. Court's seizure order.
41-3311. Confidentiality of hearings.
41-3312. Grounds for rehabilitation.
41-3313. Rehabilitation orders.
41-3314. Powers and duties of the rehabilitator.
41-3315. Actions by and against rehabilitator.
41-3316. Termination of rehabilitation.
41-3317. Grounds for liquidation.
41-3318. Liquidation orders.
41-3319. Continuance of coverage.
41-3320. Insurer—Dissolution.
41-3321. Powers of liquidator.
41-3322. Notice to creditors and others.
41-3323. Duties of agents.
41-3324. Actions by and against liquidator.
41-3325. Collection and list of assets.

SECTION.

41-3326. Fraudulent transfers prior to petition.
41-3327. Fraudulent transfer after petition.
41-3328. Voidable preferences and liens.
41-3329. Claims of holders of void or voidable rights.
41-3330. Setoffs and counterclaims.
41-3331. Assessments.
41-3332. Reinsurer's liability.
41-3333. Recovery of premiums owed.
41-3334. Domiciliary liquidator's proposal to distribute assets.
41-3335. Filing of claims.
41-3336. Proof of claim.
41-3337. Special claims.
41-3338. Special provisions for third party claims.
41-3339. Disputed claims.
41-3340. Claims of surety.
41-3341. Secured creditor's claims.
41-3342. Priority of distribution.
41-3343. Liquidator's recommendations to the court.
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41-3345. Unclaimed and withheld funds.
41-3346. Termination of proceedings.
41-3347. Reopening liquidation.
41-3348. Disposition of records during and after termination of liquidation.
41-3349. External audit of the receiver's books.
41-3350. Conservation of property of foreign or alien insurers found in this state.
41-3351. Liquidation of property of foreign or alien insurers found in this state.
41-3352. Domiciliary liquidators in other states.
41-3353. Ancillary formal proceedings.

SECTION.

41-3354. Ancillary summary proceedings.
41-3355. Claims of nonresidents against insurers domiciled in this state.
41-3356. Claims of residents against insurers domiciled in reciprocal states.
41-3357. Attachment, garnishment, and levy of execution.
41-3358. Interstate priorities.
41-3359. Subordination of claims for noncooperation.
41-3360. Severability.

41-3301. Construction and purpose.—(1) This act shall be cited as the "Idaho Insurers Supervision, Rehabilitation, and Liquidation Act."

(2) This act shall not be interpreted to limit the powers granted the director by other provisions of the law.

(3) This act shall be liberally construed to effect the purpose stated in subsection (4) of this section.

(4) The purpose of this act is the protection of the interests of insureds, claimants, creditors, and the public generally, with minimum interference with the normal prerogatives of the owners and managers of insurers through:

(a) Early detection of any potentially dangerous condition in an insurer, and prompt application of appropriate corrective measures;

(b) Improved methods for rehabilitating insurers, involving the cooperation and management expertise of the insurance industry;

(c) Enhanced efficiency and economy of liquidation, through clarification of the law, to minimize legal uncertainty and litigation;

(d) Equitable apportionment of any unavoidable loss;

(e) Lessening the problems of interstate rehabilitation and liquidation by facilitating cooperation between states in the liquidation process, and by extending the scope of personal jurisdiction over debtors of the insurer outside this state; and

(f) Regulation of the insurance business by the impact of the law relating to delinquency procedures and substantive rules on the entire insurance business. [I.C., § 41-3301, as added by 1981, ch. 249, § 2, p. 502.]

41-3302. Persons covered.—The proceedings authorized by this act may be applied to:

(1) All insurers who are doing, or have done, an insurance business in this state, and against whom claims arising from that business may exist now or in the future.

(2) All insurers who purport to do an insurance business in this state.

(3) All insurers who have insureds resident in this state.

(4) All other persons organized or in the process of organizing with the intent to do an insurance business in this state.

(5) All nonprofit service plans and all fraternal benefit societies and beneficial societies.

(6) All title insurance companies. [I.C., § 41-3302, as added by 1981, ch. 249, § 2, p. 502.]

41-3303. Definitions.—For the purposes of this act:

(1) "Ancillary state" means any state other than a domiciliary state.

(2) "Director" means the director of the department of insurance of this state.

(3) "Creditor" is a person having any claim, whether matured or unmatured, liquidated or unliquidated, secured or unsecured, absolute, fixed or contingent.

(4) "Delinquency proceeding" means any proceeding instituted against an insurer for the purpose of liquidating, rehabilitating, reorganizing or conserving such insurer, and any summary proceeding under sections 41-3309 and 41-3310, Idaho Code. "Formal delinquency proceeding" means any liquidation or rehabilitation proceeding.

(5) "Doing business" includes any of the following acts, whether effected by mail or otherwise:

(a) The issuance or delivery of contracts of insurance to persons resident in this state;

(b) The solicitation of applications for such contracts, or other negotiations preliminary to the execution of such contracts;

(c) The collection of premiums, membership fees, assessments, or other consideration for such contracts; or

(d) The transaction of matters subsequent to execution of such contracts and arising out of them.

(e) Operating under a license or certificate of authority, as an insurer, issued by the insurance department.

(6) "Domiciliary state" means the state in which an insurer is incorporated or organized, or, in the case of an alien insurer, its state of entry.

(7) "Fair consideration" is given for property or obligation:

(a) When in exchange for such property or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or services are rendered or an obligation is incurred or an antecedent debt is satisfied; or

(b) When such property or obligation is received in good faith to secure a present advance or antecedent debt in an amount not disproportionately small as compared to the value of the property or obligation obtained.

(8) "Foreign country" means any other jurisdiction not in any state.

(9) "General assets" mean all property, real, personal, or otherwise, not specifically mortgaged, pledged, deposited, or otherwise encumbered for the security or benefit of specified persons or classes of persons. As to specifically encumbered property, "general assets" include all such property or its proceeds in excess of the amount necessary to discharge the sum or sums secured thereby. Assets held in trust and on deposit for the security or benefit of all policyholders or all policyholders and creditors, in more than a single state, shall be treated as general assets.

(10) "Guaranty association" means the Idaho insurance guaranty association created by chapter 36, title 41, Idaho Code, the Idaho life and health insurance guaranty association created by chapter 43, title 41, Idaho Code, and any other similar entity now or hereafter created by the legislature of this state for the payment of claims of insolvent insurers. "Foreign guaranty association" means any similar entities now in existence in or hereafter created by the legislature of any other state.

(11) "Insolvency" or "insolvent" means:

(a) For an insurer issuing only assessable fire insurance policies:

1. The inability to pay any obligation within thirty (30) days after it becomes payable; or

2. If an assessment be made within thirty (30) days after such date, the inability to pay such obligation thirty (30) days following the date specified in the first assessment notice issued after the date of loss.

(b) For any other insurer, that it is unable to pay its obligations when they are due, or when its admitted assets do not exceed its liabilities plus the greater of:

1. Any capital and surplus required by law for its organization; or

2. The total par or stated value of its authorized and issued capital stock.

(c) As to any insurer licensed to do business in this state as of the effective date [July 1, 1981] of this act which does not meet the standard established

under paragraph 2, the term "insolvency" or "insolvent" shall mean, for a period not to exceed three (3) years from the effective date of this act, that it is unable to pay its obligations when they are due or that its admitted assets do not exceed its liabilities plus any required capital contribution ordered by the director under provisions of the insurance law.

(d) For purposes of this subsection, "liabilities" shall include, but not be limited to, reserves required by statute or by insurance department general regulations or specific requirements imposed by the director upon a subject company at the time of admission or subsequent thereto.

(12) "Insurer" means any person who has done, purports to do, is doing or is licensed to do an insurance business, and is or has been subject to the authority of, or to liquidation, rehabilitation, reorganization, supervision or conservation by any insurance director. For purposes of this act, any other persons included under section 41-3302, Idaho Code, shall be deemed to be insurers.

(13) "Preferred claim" means any claim with respect to which the terms of this act accord priority of payment from the general assets of the insurer.

(14) "Receiver" means receiver, liquidator, rehabilitator, or conservator as the context requires.

(15) "Reciprocal state" means any state other than this state in which in substance and effect sections 41-3318 (1), 41-3352, 41-3353 and 41-3355 through 41-3357, Idaho Code, are in force, and in which provisions are in force requiring that the director or equivalent official be the

receiver of a delinquent insurer, and in which some provision exists for the avoidance of fraudulent conveyances and preferential transfers.

(16) "Secured claim" means any claim secured by mortgage, trust, deed, pledge, deposit as security, escrow, or otherwise, but not including special deposit claims or claims against general assets. The term also includes claims which have become liens upon specific assets by reason of judicial process.

(17) "Special deposit claim" means any claim secured by a deposit made pursuant to statute for the security or benefit of a limited class or classes of persons, but not including any claim secured by general assets.

(18) "State" means any state, district, or territory of the United States and the Panama Canal Zone.

(19) "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein, or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily, by or without judicial proceedings. The retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by the debtor. [I.C., § 41-3303, as added by 1981, ch. 249, § 2, p. 502.]

41-3304. Jurisdiction and venue.—(1) No delinquency proceeding shall be commenced under this chapter by anyone other than the director of this state and no court shall have jurisdiction to entertain, hear or determine any proceeding commenced by any other person.

(2) No court of this state shall have jurisdiction to entertain, hear or determine any complaint praying for the dissolution, liquidation, rehabilitation, sequestration, conservation or receivership of any insurer, or praying for an injunction or restraining order or other relief preliminary to, incidental to or relating to such proceedings other than in accordance with this chapter.

(3) In addition to other grounds for jurisdiction provided by the laws of this state, a court of this state having jurisdiction of the subject matter has jurisdiction over a person served pursuant to the Idaho rules of civil procedure or other applicable provisions of law in an action brought by the receiver of a domestic insurer or an alien insurer domiciled in this state:

(a) If the person served is obligated to the insurer in any way as an incident to any agency or brokerage arrangement that may exist or has existed between the insurer and the agent or broker, in any action on or incident to the obligation; or

(b) If the person served is a reinsurer who has at any time written a policy of reinsurance for an insurer against which a rehabilitation or liquidation order is in effect when the action is commenced, or is an agent or broker of or for the reinsurer, in any action on or incident to the reinsurance contract; or

(c) If the person served is or has been an officer, manager, trustee, organizer, promoter, or person in a position of comparable authority or influence in an insurer, against which a rehabilitation or liquidation order is in effect when the action is commenced, in any action resulting from such a relationship with the insurer.

(4) If the court on motion of any party finds that any action should as a matter of substantial justice be tried in a forum outside this state, the court may enter an appropriate order to stay further proceedings on the action in this state.

(5) All actions herein authorized shall be brought in the district court for Ada county, state of Idaho. [I.C., § 41-3304, as added by 1981, ch. 249, § 2, p. 502.]

41-3305. Injunctions and orders.—(1) Any receiver appointed in a proceeding under this act, may at any time apply for and any court of general jurisdiction may grant, such restraining orders, preliminary and permanent injunctions, and other orders as may be deemed necessary and proper to prevent:

(a) The transaction of further business;

(b) The transfer of property;

(c) Interference with the receiver or with a proceeding under this act;

(d) Waste of the insurer's assets;

(e) Dissipation and transfer of bank accounts;

(f) The institution or further prosecution of any actions or proceedings;

(g) The obtaining of preferences, judgments, attachments, garnishments, or liens against the insurer, its assets or its policyholders;

(h) The levying of execution against the insurer, its assets, or its policyholders;

(i) The making of any sale or deed for nonpayment of taxes or assessments that would lessen the value of the assets of the insurer; or

(j) The withholding from the receiver of books, accounts, documents, or other records relating to the business of the insurer; or

(k) Any other threatened or contemplated action that might lessen the value of the insurer's assets or prejudice the rights of policyholders, creditors, or shareholders, or the administration of any proceeding under this act.

(2) The receiver may apply to any court outside of the state for the relief described in subsection (1) of this section. [I.C., § 41-3305, as added by 1981, ch. 249, § 2, p. 502.]

41-3306. Cooperations of officers, owners, and employees.—(1) Any officer, manager, director, trustee, owner, employee, or agent of any insurer, or any other persons with authority over or in charge of any segment of the insurer's affairs, shall cooperate with the director in any proceeding under this act or any investigation preliminary to the proceeding. The term "person," as used in this section, shall include any person who exercises control directly or indirectly over activities of an insurer through any holding company or other affiliate of the insurer. "To cooperate" shall include, but shall not be limited to, the following:

(a) To reply promptly in writing to any inquiry from the director requesting such a reply; and

(b) To make available to the director any books, accounts, documents, or other records or information or property of or pertaining to the insurer and in his possession, custody or control.

(2) No person shall obstruct or interfere with the director in the conduct of any delinquency proceeding or any investigation preliminary or incidental thereto.

(3) This section shall not be construed to abridge otherwise existing legal rights, including the right to resist a petition for liquidation or other delinquency proceedings, or other orders.

(4) Any person included within subsection (1) of this section who fails to cooperate with the director, or any person who obstructs or interferes with the director in the conduct of any delinquency proceeding or any investigation preliminary or incidental thereto, or who violates any order the director issued validly under this act may:

(a) Be sentenced to pay a fine not exceeding ten thousand dollars ($10,000) or to undergo imprisonment for a term of not more than one (1) year, or both; or

(b) After a hearing, be subject to the imposition by the director, of a civil penalty not to exceed ten thousand dollars ($10,000) and shall be subject further to the revocation or suspension of any insurance licenses issued by the director. [I.C., § 41-3306, as added by 1981, ch. 249, § 2, p. 502.]

41-3307. Bonds.—In any proceeding under this act, the director and his deputies shall be responsible on their official bonds for the faithful performance of their duties. If the court deems it desirable for the protection of the assets, it may at any time require an additional bond from the director or his deputies, and such bonds shall be paid for out of the assets of the insurer as a cost of

administration. [I.C., § 41-3307, as added by 1981, ch. 249, § 2, p. 502.]

41-3308. Continuation of delinquency proceedings.—Every proceeding heretofore commenced under the laws in effect before the enactment of this act shall be deemed to have commenced under this act for the purpose of conducting the proceeding henceforth, except that in the discretion of the director the proceeding may be continued, in whole or in part, as it could have been continued had this act not been enacted. [I.C., § 41-3308, as added by 1981, ch. 249, § 2, p. 502.]

41-3309. Director's summary orders and supervision proceedings.—(1) Whenever the director has reasonable cause to believe, and determines, after a hearing held under subsection 5 of this section, that any domestic insurer has committed or engaged in, or is about to commit or engage in, any act, practice, or transaction that would subject it to delinquency proceedings under this act, he may make and serve upon the insurer and any other persons involved, such orders as are reasonably necessary to correct, eliminate, or remedy such conduct, condition, or ground.

(2) If upon examination, or at any other time, the director has reasonable cause to believe that any domestic insurer is in such condition as to render the continuance of its business hazardous to the public or to holders of its policies or certificates of insurance, or if such domestic insurer gives its consent, then the director shall, upon his determination:

(a) Notify the insurer of his determination; and

(b) Furnish to the insurer a written list of the director's requirements to abate his determination.

(3) If the director makes a determination to supervise an insurer subject to an order under subsections (1) and (2) of this section, he shall notify the insurer that it is under the supervision of the director. During the period of supervision, the director may appoint a supervisor to supervise such insurer. The order appointing a supervisor shall direct the supervisor to enforce orders issued under subsections (1) and (2) of this section and may also require that the insurer may not do any of the following things, during the period of supervision, without the prior approval of the director or his supervisor:

(a) Dispose of, convey or encumber any of its assets or its business in force;

(b) Withdraw from any of its bank accounts;

(c) Lend any of its funds;

(d) Invest any of its funds;

(e) Transfer any of its property;

(f) Incur any debt, obligation or liability;

(g) Merge or consolidate with another company; or

(h) Enter into any new reinsurance contract or treaty.

(4) Any insurer subject to an order under the provisions of this section shall comply with the lawful requirements of the director and, if placed under supervision, shall have sixty (60) days from the date the supervision order is served within which to comply with

the requirements of the director. In the event of such insurer's failure to comply within such times, the director may institute proceedings under sections 41-3312 or 41-3317, Idaho Code, to have a rehabilitator or liquidator appointed, or extend the period of supervision.

(5) The notice of hearing under subsection (1) of this section and any order issued pursuant to such subsection shall be served upon the insurer pursuant to the applicable rules of civil or administrative procedure. The notice of hearing shall state the time and place of hearing, and the conduct, condition or ground upon which the director would base his order. Unless mutually agreed between the director and the insurer, the hearing shall occur not less than ten (10) days nor more than thirty (30) days after notice is served and shall be either in Ada county or in some other place convenient to the parties to be designated by the director. The director shall hold all hearings under subsection (1) of this section privately unless the insurer requests a public hearing, in which case the hearing shall be public.

(6)(a) Any insurer subject to order under subsection (2) of this section may request a hearing to review that order. Such a hearing shall be held as provided in subsection (5) hereof, but the request for a hearing shall not stay the effect of the order.

(b) If the director issues an order under subsection (2) of this section, the insurer may, at any time, waive a director's hearing and apply for immediate judicial relief by means of any remedy afforded by law without first exhausting administrative remedies. Subsequent to a hearing, any party to the proceedings whose interests are substantially affected shall be entitled to judicial review of any order issued by the director.

(7) During the period of supervision the insurer may request the director to review an action taken or proposed to be taken by the supervisor, specifying wherein the action complained of is believed not to be in the best interest of the insurer.

(8) If any person has violated any supervision order issued under the provisions of this section which, as applied to him was then still in effect, he shall be liable to pay a civil penalty imposed by the district court not to exceed ten thousand dollars ($10,000).

(9) The director may apply for and any court of general jurisdiction may grant, such restraining orders, preliminary and permanent injunctions, and other orders as may be deemed necessary and proper to enforce a supervision order.

(10) In the event that any person, subject to the provisions of this act, including those persons described in section 41-3306(1), Idaho Code, shall knowingly violate any valid order of the director issued under the provisions of this section and, as a result of such violation, the net worth of the insurer shall be reduced or the insurer shall suffer loss it would not otherwise have suffered, said person shall become personally liable to the insurer for the amount of any such reduction or loss. The director or supervisor is authorized to bring an action on behalf of the insurer in the district court to recover the amount of the reduction or loss together with any costs. [I.C., § 41-3309, as added by 1981, ch. 249, § 2, p. 502.]

41-3310. Court's seizure order.—(1) The director may file in the district court of this state a petition alleging, with respect to a domestic insurer:

(a) That any grounds exist that would justify a court order for a formal delinquency proceeding against an insurer under this act;

(b) That the interests of policyholders, creditors, or the public will be endangered by delay; and

(c) The contents of an order deemed necessary by the director.

(2) Upon a filing under subsection (1) of this section, the court may issue forthwith, ex parte and without a hearing, the requested order which shall direct the director to take possession and control of all or a part of the property, books, accounts, documents, and other records of an insurer, and of the premises occupied by it for transaction of its business, and until further order of the court enjoin the insurer and its officers, managers, agents, and employees from disposition of its property and from transaction of its business except with the written consent of the director.

(3) The court shall specify in the order what its duration shall be, which shall be such time as the court deems necessary for the director to ascertain the condition of the insurer. On motion of either party or on its own motion, the court may from time to time hold such hearings as it deems desirable after such notice as it deems appropriate, and may extend, shorten, or modify the terms of the seizure order. The court shall vacate the seizure order if the director fails to commence a formal proceeding under this act after having had a reasonable opportunity to do so. An order of the court pursuant to a formal proceeding under this act shall ipso facto vacate the seizure order.

(4) Entry of a seizure order under the provisions of this section shall not constitute an anticipatory breach of any contract of the insurer.

(5) An insurer subject to an ex parte order under the provisions of this section may petition the court at any time after the issuance of such order for a hearing and review of the order. The court shall hold such a hearing and review not more than fifteen (15) days after the request. A hearing under the provisions of this subsection may be held privately in chambers and it shall be so held if the insurer proceeded against so requests.

(6) If, at any time after the issuance of such an order, it appears to the court that any person whose interest is or will be substantially affected by the order did not appear at the hearing and has not been served, the court may order that notice be given. An order that notice be given shall not stay the effect of any order previously issued by the court. [I.C., § 41-3310, as added by 1981, ch. 249, § 2, p. 502.]

41-3311. Confidentiality of hearings.—In all proceedings and judicial reviews thereof under sections 41-3309 and 41-3310, Idaho Code, all records of the insurer, other documents, and all insurance department files and court records and papers, so far as they pertain to or are a part of the record of the proceedings, shall be and remain confidential except as is necessary to obtain compliance therewith, unless and until the district court, after hearing arguments from the parties in chambers, shall order otherwise, or unless the insurer requests that the matter be made public. Until such court order, all papers filed with the clerk of the district court shall be held by him in a confidential file. [I.C., § 41-3311, as added by 1981, ch. 249, § 2, p. 502.]

41-3312. Grounds for rehabilitation.—The director may apply by petition to the district court for an order

authorizing him to rehabilitate a domestic insurer or an alien insurer domiciled in this state on any one or more of the following grounds:

(1) The insurer is in such condition that the further transaction of business would be hazardous, financially, to its policyholders, creditors, or the public.

(2) There is reasonable cause to believe that there has been embezzlement from the insurer, wrongful sequestration or diversion of the insurer's assets, forgery or fraud affecting the insurer, or other illegal conduct in, by or with respect to the insurer that if established would endanger assets in an amount threatening the solvency of the insurer.

(3) The insurer has failed to remove any person who in fact has executive authority in the insurer, whether an officer, manager, general agent, employee, or other person, if the person has been found after notice and hearing by the director to be dishonest or untrustworthy in a way affecting the insurer's business.

(4) Control of the insurer, whether by stock ownership or otherwise, and whether direct or indirect, is in a person or persons found after notice and hearing to be untrustworthy.

(5) Any person who in fact has executive authority in the insurer, whether an officer, manager, general agent, director or trustee, employee, or other person, has refused to be examined under oath by the director concerning its affairs, whether in this state or elsewhere, and after reasonable notice of the fact the insurer has failed promptly and effectively to terminate the employment and status of the person and all his influence on management.

(6) After demand by the director under the provisions of section 41223, Idaho Code, under this act, the insurer has failed to promptly make available for examination any of its own property, books, accounts, documents, or other records, or those of any subsidiary or related company within the control of the insurer, or those of any person having executive authority in the insurer so far as they pertain to the insurer.

(7) Without first obtaining the written consent of the director, the insurer has transferred, or attempted to transfer, in a manner contrary to chapter 38, title 41, Idaho Code, or sections 41-2856 and 41-2858, Idaho Code, substantially its entire property or business, or has entered into any transaction the effect of which is to merge, consolidate, or reinsure substantially its entire property or business in or with the property or business of any other person.

(8) The insurer or its property has been or is the subject of an application for the appointment of a receiver, trustee, custodian, conservator or sequestrator or similar fiduciary of the insurer or its property otherwise than as authorized under the insurance laws of this state, and such appointment has been made or is imminent, and such appointment might oust the courts of this state of jurisdiction or might prejudice orderly delinquency proceedings under this act.

(9) Within the previous six (6) years the insurer has willfully violated its charter or articles of incorporation, its bylaws, any insurance law of this state, or any valid order of the director under the provisions of section 41-3309, Idaho Code.

(10) The insurer has failed to pay within sixty (60) days after due date any obligation to any state or any subdivision thereof or any judgment entered in any state, if the court in which such judgment was entered had jurisdiction over such subject matter except that such nonpayment shall not be a ground until sixty (60) days after any good faith effort by the insurer to contest the obligation has been terminated, whether it is before the director or in the courts, or the insurer has systematically attempted to compromise or renegotiate previously agreed settlements with its creditors on the ground that it is financially unable to pay its obligations in full.

(11) The insurer has failed to file its annual report or other financial report required by statute within the time allowed by law and, after written demand by the director, has failed to give an adequate explanation immediately.

(12) The board of directors or the holders of a majority of the shares entitled to vote, or a majority of those individuals entitled to the control of those entities specified in section 41-3801, Idaho Code, request or consent to rehabilitation under this act. [I.C., § 41-3312, as added by 1981, ch. 249, § 2, p. 502.]

41-3313. Rehabilitation orders.—(1) An order to rehabilitate the business of a domestic insurer, or an alien insurer domiciled in this state, shall appoint the director and his successors in office the rehabilitator, and shall direct the rehabilitator forthwith to take possession of the assets of the insurer, and to administer them under the general supervision of the court. The filing or recording of the order with the clerk of the district court or recorder of deeds of the county in which the prin-

cipal business of the company is conducted, or the county in which its principal office or place of business is located, shall impart the same notice as a deed, bill of sale, or other evidence of title duly filed or recorded with that recorder of deeds would have imparted. The order to rehabilitate the insurer shall by operation of law vest title to all assets of the insurer in the rehabilitator.

(2) Any order issued under this section shall require accounting to the court by the rehabilitator. Accountings shall be at such intervals as the court specifies in its order.

(3) Entry of an order of rehabilitation shall not constitute an anticipatory breach of any contracts of the insurer. [I.C., § 41-3313, as added by 1981, ch. 249, § 2, p. 502.]

41-3314. Powers and duties of the rehabilitator.—(1) The director as rehabilitator may appoint one or more special deputies, who shall have all the powers and responsibilities of the rehabilitator granted under the provisions of this section, and the director may employ such counsel, clerks, and assistants as deemed necessary. The compensation of the special deputy, counsel, clerks, and assistants and all expenses of taking possession of the insurer and of conducting the proceedings shall be fixed by the director, with the approval of the court and shall be paid out of the funds or assets of the insurer. The persons appointed under this section shall serve at the pleasure of the director. In the event that the property of the insurer does not contain sufficient cash or liquid assets to defray the costs incurred, the director may advance the costs so incurred out of any appropriation

for the maintenance of the insurance department. Any amounts so advanced for expenses of administration shall be repaid to the director for the use of the insurance department out of the first available money of the insurer.

(2) The rehabilitator may take such action as he deems necessary or appropriate to reform and revitalize the insurer. He shall have all the powers of the directors, officers, and managers, whose authority shall be suspended, except as they are redelegated by the rehabilitator. He shall have full power to direct and manage, to hire and discharge employees subject to any contract rights they may have, and to deal with the property and business of the insurer.

(3) If it appears to the rehabilitator that there has been criminal or tortious conduct, or breach of any contractual or fiduciary obligation detrimental to the insurer by any officer, manager, agent, broker, employee, or other person, he may pursue all appropriate legal remedies on behalf of the insurer.

(4) If the rehabilitator determines that reorganization, consolidation, conversion, reinsurance, merger, or other transformation of the insurer is appropriate, he shall prepare a plan to effect such changes. Upon application of the rehabilitator for approval of the plan, and after such notice and hearings as the court may prescribe, the court may either approve or disapprove the plan proposed, or may modify it and approve it as modified. Any plan approved under the provisions of this section shall be, in the judgment of the court, fair and equitable to all parties concerned. If the plan is approved, the rehabilitator shall carry out the plan. In

the case of a life insurer, the plan proposed may include the imposition of liens upon the policies of the company, if all rights of shareholders are first relinquished. A plan for a life insurer may also propose imposition of a moratorium upon loan and cash surrender rights under policies, for such period and to such an extent as may be necessary.

(5) The rehabilitator shall have the power under sections 41-3326 and 41-3327, Idaho Code, to avoid fraudulent transfers. [I.C., § 41-3314, as added by 1981, ch. 249, § 2, p. 502.]

41-3315. Actions by and against rehabilitator.—(1) Any court in this state before which any action or proceeding in which the insurer is a party or is obligated to defend a party is pending when a rehabilitation order against the insurer is entered shall stay the action or proceeding for ninety (90) days and such additional time as is necessary for the rehabilitator to obtain proper representation and prepare for further proceedings. The rehabilitator shall take such action respecting the pending litigation as he deems necessary in the interests of justice and for the protection of creditors, policyholders, and the public. The rehabilitator shall immediately consider all litigation pending outside this state and shall petition the courts having jurisdiction over that litigation for stays whenever necessary to protect the estate of the insurer.

(2) No statute of limitations or defense of laches shall run with respect to any action by or against an insurer between the filing of a petition for appointment of a rehabilitator for that insurer and the order granting or denying that petition. Any action by or against the insurer that might have been commenced when the pe-

tition was filed may be commenced for at least sixty (60) days after the order of rehabilitation is entered or the petition is denied.

(3) Any guaranty association or foreign guaranty association covering life or health insurance or annuities shall have standing to appear in any court proceeding concerning the rehabilitation of a life or health insurer if such association is or may become liable to act as a result of the rehabilitation. [I.C., § 41-3315, as added by 1981, ch. 249, § 2, p. 502.]

41-3316. Termination of rehabilitation.—(1) Whenever the director believes further attempts to rehabilitate an insurer would substantially increase the risk of loss to creditors, policyholders, or the public, or would be futile, the director may petition the district court for an order of liquidation. A petition under the provisions of this subsection shall have the same effect as a petition under the provisions of section 41-3317, Idaho Code. The district court shall permit the directors of the insurer to take such actions as are reasonably necessary to defend against the petition and may order payment from the estate of the insurer of such costs and other expenses of defense as justice may require.

(2) The rehabilitator may at any time petition the district court for an order terminating rehabilitation of an insurer. The court shall also permit the directors of the insurer to petition the court for an order terminating rehabilitation of the insurer and may order payment from the estate of the insurer of such costs and other expenses of such petition as justice may require. If the district court finds that rehabilitation has been accomplished and that grounds for rehabilitation under the provisions of section

41-3312, Idaho Code, no longer exist, it shall order that the insurer be restored to possession of its property and the control of its business. The district court may also make that finding and issue that order at any time upon its own motion. [I.C., § 41-3316, as added by 1981, ch. 249, § 2, p. 502.]

41-3317. Grounds for liquidation.—The director may petition the district court for an order directing him to liquidate a domestic insurer or an alien insurer domiciled in this state on the basis:

(1) Of any ground for an order of rehabilitation as specified in section 41-3312, Idaho Code, whether or not there has been a prior order directing the rehabilitation of the insurer;

(2) That the insurer is insolvent; or

(3) That the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, it creditors, or the public. [I.C., § 41-3317, as added by 1981, ch. 249, § 2, p. 502.]

41-3318. Liquidation orders.—(1) An order to liquidate the business of a domestic insurer shall appoint the director and his successors in office liquidator and shall direct the liquidator forthwith to take possession of the assets of the insurer and to administer them under the general supervision of the court. The liquidator shall be vested by operation of law with the title to all of the property, contracts, and rights of action and all of the books and records of the insurer ordered liquidated, wherever located, as of the entry of the final order of liquidation.

The filing or recording of the order with the clerk of the district court and the recorder of deeds of the county in which its principal office or place of business is located, or, in the case of real estate, with the recorder of deeds of the county where the property is located, shall impart the same notice as a deed, bill of sale, or other evidence of title duly filed or recorded with that recorder of deeds would have imparted.

(2) Upon issuance of the order, the rights and liabilities of any such insurer and of its creditors, policyholders, shareholders, members, and all other persons interested in its estate shall become fixed as of the date of entry of the order of liquidation, except as provided in sections 41-3319 and 41-3337, Idaho Code.

(3) An order to liquidate the business of an alien insurer domiciled in this state shall be in the same terms and have the same legal effect as an order to liquidate a domestic insurer, except that the assets and the business in the United States shall be the only assets and business included herein.

(4) At the time of petitioning for an order of liquidation, or at any time thereafter, the director, after making appropriate findings of an insurer's insolvency, may petition the court for a judicial declaration of such insolvency. After providing such notice and hearing as it deems proper the court may make the declaration.

(5) Any order issued under the provisions of this section shall require accounting to the court by the liquidator. Accountings shall be at such intervals as the court specifies in its order. [I.C., § 41-3318, as added by 1981, ch. 249, § 2, p. 502.]

41-3319. Continuance of coverage.—(1) All policies, other than life or health insurance or annuities, in effect at the time of issuance of an order of liquidation shall continue in force only for the lesser of:

(a) A period of thirty (30) days from the date of entry of the liquidation orders;

(b) The expiration of the policy coverage;

(c) The date when the insured has replaced the insurance coverage with equivalent insurance in another insurer or otherwise terminated the policy; or

(d) The liquidator has effected a transfer of the policy obligation pursuant to section 41-3321(1)(h), Idaho Code.

(2) An order or liquidation under the provisions of section 41-3318, Idaho Code, shall terminate coverages at the time specified in subsection (1) of this section for purposes of any other statute.

(3) Policies of life or health insurance or annuities shall continue in force for such period and under such terms as are provided for by any applicable guaranty association or foreign guaranty association.

(4) Policies of life or health insurance or annuities or any period or coverage of such policies not covered by a guaranty association or foreign guaranty association shall terminate under the provisions of subsections (1) and (2) hereof. [I.C., § 41-3319, as added by 1981, ch. 249, § 2, p. 502.]

41-3320. Insurer—Dissolution.—The director may petition for any order dissolving the corporate existence of

a domestic insurer or the United States branch of an alien insurer domiciled in this state at the time he applies for a liquidation order. The court shall order dissolution of the corporation upon petition by the director upon or after the granting of a liquidation order. If the dissolution has not previously been ordered, it shall be effected by operation of law upon the discharge of the liquidator if the insurer is insolvent, but may be ordered by the court upon the discharge of the liquidator if the insurer is under a liquidation order for some other reason. [I.C., § 41-3320, as added by 1981, ch. 249, § 2, p. 502.]

41-3321. Powers of liquidator.—(1) The liquidator shall have the power:

(a) To appoint a special deputy to act for him under this act, and to determine his reasonable compensation. The special deputy shall have all powers of the liquidator granted by this section. The special deputy shall serve at the pleasure of the liquidator;

(b) To employ employees and agents, legal counsel, actuaries, accountants, appraisers, consultants, and such other personnel as he may deem necessary to assist in the liquidation;

(c) To fix the reasonable compensation of employees and agents, legal counsel, actuaries, accountants, appraisers and consultants with the approval of the court;

(d) To pay reasonable compensation to persons appointed and to defray from the funds or assets of the insurer all expenses of taking possession of, conserving, conducting, liquidating, disposing of, or otherwise dealing with the business and property of the

insurer. In the event that the property of the insurer does not contain sufficient cash or liquid assets to defray the costs incurred, the director may advance the costs so incurred out of any appropriation for the maintenance of the insurance department. Any amounts so advanced for expenses of administration shall be repaid to the director for the use of the insurance department out of the first available monies of the insurer;

(e) To hold hearings, to subpoena witnesses to compel their attendance, to administer oaths, to examine any person under oath, and to compel any person to subscribe to his testimony after it has been correctly reduced to writing, and in connection therewith to require the production of any books, papers, records or other documents which he deems relevant to the inquiry;

(f) To collect all debts and monies due and claims belonging to the insurer, wherever located, and for this purpose:

1. To institute timely action in other jurisdictions, in order to forestall garnishment and attachment proceedings against such debts;

2. To do such other acts as are necessary or expedient to collect, conserve or protect its assets or property, including the power to sell, compound, compromise, or assign debts for purposes of collection upon such terms and conditions as he deems best; and

3. To pursue any creditor's remedies available to enforce his claims.

(g) To conduct public and private sales of the property of the insurer;

(h) To use assets of the estate of an insurer under a liquidation order to transfer policy obligations to a solvent assuming insurer, if the transfer can be arranged without prejudice to applicable priorities under the provisions of section 41-3342, Idaho Code;

(i) To acquire, hypothecate, encumber, lease, improve, sell, transfer, abandon, or otherwise dispose of or deal with, any property of the insurer at its market value or upon such terms and conditions as are fair and reasonable. He shall also have power to execute, acknowledge, and deliver any and all deeds, assignments, releases and other instruments necessary or proper to effectuate any sale of property or other transaction in connection with the liquidation;

(j) To borrow money on the security of the insurer's assets or without security and to execute and deliver all documents necessary to that transaction for the purpose of facilitating the liquidation;

(k) To enter into such contracts as are necessary to carry out the order to liquidate, and to affirm or disavow any contracts to which the insurer is a party;

(l) To continue to prosecute and to institute in the name of the insurer or in his own name any and all suits and other legal proceedings, in this state or elsewhere, and to abandon the prosecution of claims he deems unprofitable to pursue further. If the insurer is dissolved under the provisions of section 41-3320, Idaho Code, he shall have the power to apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff;

(m) To prosecute any action which may exist in behalf of the creditors, members, policyholders or shareholders of the insurer against any officer of the insurer, or any other person;

(n) To demove any or all records and property of the insurer to the offices of the director or to such other place as may be convenient for the purposes of efficient and orderly execution of the liquidation. Guaranty associations and foreign guaranty associations shall have such reasonable access to the records of the insurer as is necessary for them to carry out their statutory obligations;

(o) To deposit in one or more banks in this state such sums as are required for meeting current administration expenses and dividend distributions;

(p) To invest all sums not currently needed, unless the court orders otherwise;

(q) To file any necessary documents for record in the office of any recorder of deeds or records office in this state or elsewhere where property of the insurer is located;

(r) To assert all defenses available to the insurer as against third persons, including statutes of limitation, statutes of frauds, and the defense of usury. A waiver of any defense by the insurer after a petition in liquidation has been filed shall not bind the liquidator. Whenever a guaranty association or foreign guaranty association has an obligation to defend any suit, the liquidator shall give precedence to such obligation and may defend only in the absence of a defense by such guaranty associations;

(s) To exercise and enforce all the rights, remedies, and powers of any creditor, shareholder, policyholder, or member, including any power to avoid any transfer or lien that may be given by the general law and that is not included within sections 41-3326 through 41-3328, Idaho Code;

(t) To intervene in any proceeding wherever instituted that might lead to the appointment of a receiver or trustee, and to act as the receiver or trustee whenever the appointment is offered;

(u) To enter into agreements with any receiver or director of any other state relating to the rehabilitation, liquidation, conservation or dissolution of an insurer doing business in both states; and

(v) To exercise all powers now held or hereafter conferred upon receivers by the laws of this state not inconsistent with the provisions of this act.

(2) The enumeration, in this section, of the powers and authority of the liquidator shall not be construed as a limitation upon him, nor shall it exclude in any manner his right to do such other acts not herein specifically enumerated, or otherwise provided for, as may be necessary or appropriate for the accomplishment of or in aid of the purpose of liquidation. [I.C., § 41-3321, as added by 1981, ch. 249, § 2, p. 502.]

41-3322. Notice to creditors and others.—(1) Unless the court otherwise directs, the liquidator shall give or cause to be given notice of the liquidation order as soon as possible:

(a) By first class mail and either by telegram or telephone to the insurance director of each jurisdiction in which the insurer is doing business;

(b) By first class mail to any guaranty association or foreign guaranty association which is or may become obligated as a result of the liquidation;

(c) By first class mail to all insurance agents of the insurer;

(d) By first class mail to all persons known or reasonably expected to have claims against the insurer, including, but not limited to, all policyholders, at their last known address as indicated by the records of the insurer and the director of the department of finance and the secretary of state; and

(e) By publication in a newspaper of general circulation in the county in which the insurer has its principal place of business and in such other locations as the liquidator deems appropriate.

(2) Notice to potential claimants under the provisions of subsection (1) of this section shall require claimants to file their claims with the liquidator together with proper proofs thereof under the provisions of section 41-3336, Idaho Code, on or before a date the liquidator shall specify in the notice. The liquidator need not require persons claiming cash surrender values or other investment values in life insurance and annuities to file a claim. All claimants shall have a duty to keep the liquidator informed of any changes of address.

(3) If notice is given in accordance with the provisions of this section, the distribution of assets of the insurer under this chapter shall be conclusive with respect to all claimants, whether or not they received notice. [I.C., § 41-3322, as added by 1981, ch. 249, § 2, p. 502.]

41-3323. Duties of agents.—(1) Every person who receives notice in the form prescribed in section 41-3322, Idaho Code, that an insurer which he represents as an agent is the subject of a liquidation order, shall within fifteen (15) days of such notice give notice of the liquidation order. The notice shall be sent by first class mail to the last address contained in the agent's records to each policyholder or other person named in any policy issued through the agent by the insurer, if he has a record of the address of the policyholder or other person. A policy shall be deemed issued through an agent if the agent has a property interest in the expiration of the policy, or if the agent has had in his possession a copy of the declarations of the policy at any time during the life of the policy, except where the ownership of the expiration of the policy has been transferred to another. The written notice shall include the name and address of the insurer, the name and address of the agent, identification of the policy impaired and the nature of the impairment including termination of coverage, as described in section 41-3319, Idaho Code. Notice by a general agent satisfies the notice requirement for any agents under contract to him. Each agent obligated to give notice under the provisions of this section shall file a report of compliance with the liquidator.

(2) Any agent failing to give notice or file a report of compliance as required in subsection (1) of this section may be subject of payment of a penalty of not more than one thousand dollars ($1,000) and may have his license suspended, said penalty to be imposed after a hearing held by the director.

(3) The liquidator may waive the duties imposed by this section if he determines that other notice to the

policyholders of the insurer under liquidation is adequate. [I.C., § 41-3323, as added by 1981, ch. 249, § 2, p. 502.]

41-3324. Actions by and against liquidator.—(1) Upon issuance of an order appointing a liquidator of a domestic insurer or of an alien insurer domiciled in this state, no action at law or equity shall be brought against the insurer or liquidator, whether in this state or elsewhere, nor shall any such existing actions be maintained or further presented after issuance of such order. The courts of this state shall give full faith and credit to injunctions against the liquidator or the company or the continuation of existing actions against the liquidator or the company, when such injunctions are included in an order to liquidate an insurer issued pursuant to corresponding provisions in other states. Whenever in the liquidator's judgment, protection of the estate of the insurer necessitates intervention in an action against the insurer that is pending outside this state, he may intervene in the action. The liquidator may defend any action in which he intervenes under the provisions of this section at the expense of the estate of the insurer.

(2) The liquidator may, upon or after an order for liquidation, within two (2) years or such time in addition to two (2) years as applicable law may permit, institute an action or proceeding on behalf of the estate of the insurer upon any cause of action against which the period of limitation fixed by applicable law has not expired at the time of the filing of the petition upon which such order is entered. Where, by any agreement, a period of limitation is fixed for instituting a suit or proceeding upon any claim, or for filing any claim, proof of claim, proof of loss, demand, notice, or the like, or

where in any proceeding, judicial or otherwise, a period of limitation is fixed, either in the proceeding or by applicable law, for taking any action, filing any claim or pleading, or doing any act, and where in any such case the period had not expired at the date of the filing of the petition, the liquidator may, for the benefit of the estate, take any such action or do any such act, required of or permitted to the insurer, within a period of one hundred eighty (180) days subsequent to the entry of an order for liquidation, or within such further period as is shown to the satisfaction of the court not to be unfairly prejudicial to the other party.

(3) No statute of limitations or defense of laches shall run with respect to any action against an insurer between the filing of a petition for liquidation against an insurer and the denial of the petition. Any action against the insurer that might have been commenced when the petition was filed may be commenced for at least sixty (60) days after the petition is denied.

(4) Any guaranty association or foreign guaranty association shall have standing to appear in any court proceeding concerning the liquidation of an insurer if such association is or may become liable to act as a result of the liquidation. [I.C., § 41-3324, as added by 1981, ch. 249, § 2, p. 502.]

41-3325. Collection and list of assets.—(1) As soon as practicable after the liquidation order but not later than one hundred twenty (120) days thereafter, the liquidator shall prepare in duplicate a list of the insurer's assets. The list shall be amended or supplemented from time to time as the liquidator may determine. One (1) copy shall be filed in the office of the clerk of the district

court and one (1) copy shall be retained for the liquidator's files. All amendments and supplements shall be similarly filed.

(2) The liquidator shall reduce the assets to a degree of liquidity that is consistent with the effective execution of the liquidation.

(3) A submission to the court for disbursement of assets in accordance with section 41-3334, Idaho Code, fulfills the requirements of subsection (1) of this section. [I.C., § 41-3325, as added by 1981, ch. 249, § 2, p. 502.]

41-3326. Fraudulent transfers prior to petition.—(1) Every transfer made or suffered and every obligation incurred by an insurer within one (1) year prior to the filing of a successful petition for rehabilitation or liquidation under this act is fraudulent as to then existing and future creditors if made or incurred without fair consideration, or with actual intent to hinder, delay, or defraud either existing or future creditors. A transfer made or an obligation incurred by an insurer ordered to be rehabilitated or liquidated under this act, which is fraudulent under the provisions of this section, may be avoided by the receiver, except as to a person who in good faith is a purchaser, lienor, or obligee for a present fair equivalent value, and except that any purchaser, lienor, or obligee, who in good faith has given a consideration less than fair for such transfer, lien, or obligation, may retain the property, lien or obligation as security for repayment. The court may, on due notice, order any such transfer or obligation to be preserved for the benefit of the estate, and in that event, the receiver shall succeed to and may enforce the rights of the purchaser, lienor, or obligee.

(2) (a) A transfer of property other than real property shall be deemed to be made or suffered when it becomes so far perfected that no subsequent lien obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee under the provisions of section 41-3328(3), Idaho Code.

(b) A transfer of real property shall be deemed to be made or suffered when it becomes so far perfected that no subsequent bona fide purchaser from the insurer could obtain rights superior to the rights of the transferee.

(c) A transfer which creates an equitable lien shall not be deemed to be perfected if there are available means by which a legal lien could be created.

(d) Any transfer not perfected prior to the filing of a petition for liquidation shall be deemed to be made immediately before the filing of the successful petition.

(e) The provisions of this subsection apply whether or not there are or were creditors who might have obtained any liens or persons who might have become bona fide purchasers.

(3) Any transaction of the insurer with a reinsurer shall be deemed fraudulent and may be avoided by the receiver under subsection (1) of this section if:

(a) The transaction consists of the termination, adjustment, or settlement of a reinsurance contract in which the reinsurer is released from any part of its duty to pay the originally specified share of losses that had occurred prior to the time of the transaction,

unless the reinsurer gives a present fair equivalent value for the release; and

(b) Any part of the transaction took place within one (1) year prior to the date of filing of the petition through which the receivership was commenced. [I.C., § 41-3326, as added by 1981, ch. 249, § 2, p. 502.]

41-3327. Fraudulent transfer after petition.—(1) After a petition for rehabilitation or liquidation has been filed, a transfer of any of the real property of the insurer made to a person acting in good faith shall be valid against the receiver if made for a present fair equivalent value, or, if not made for a present fair equivalent value, then to the extent of the present consideration actually paid therefor, for which amount the transferee shall have a lien on the property so transferred. The commencement of a proceeding in rehabilitation or liquidation shall be constructive notice upon the recording of a copy of the petition for or order of rehabilitation or liquidation with the recorder of deeds in the county where any real property in question is located. The exercise by a court of the United States or any state or jurisdiction to authorize or effect a judicial sale of real property of the insurer within any county in any state shall not be impaired by the pendency of such a proceeding unless the copy is recorded in the county prior to the consummation of the judicial sale.

(2) After a petition for rehabilitation or liquidation has been filed and before either the receiver takes possession of the property of the insurer or an order of rehabilitation or liquidation is granted:

(a) A transfer of any of the property of the insurer, other than real property, made to a person acting

in good faith shall be valid against the receiver if made for a present fair equivalent value, or, if not made for a present fair equivalent value, then to the extent of the present consideration actually paid therefor, for which amount the transferee shall have a lien on the property so transferred;

(b) A person indebted to the insurer or holding property of the insurer may, if acting in good faith, pay the indebtedness or deliver the property, or any part thereof, to the insurer or upon his order, with the same effect as if the petition were not pending;

(c) A person having actual knowledge of the pending rehabilitation or liquidation shall be deemed not to act in good faith; and

(d) A person asserting the validity of a transfer under this section shall have the burden of proof. Except as elsewhere provided in this section, no transfer by or on behalf of the insurer after the date of the petition for liquidation by any person other than the liquidator shall be valid against the liquidator.

(3) Nothing in this act shall impair the negotiability of currency or negotiable instruments. [I.C., § 41-3327, as added by 1981, ch. 249, § 2, p. 502.]

41-3328. Voidable preferences and liens.—(1) A preference is a transfer of any of the property of an insurer to or for the benefit of a creditor, for or on account of an antecedent debt, made or suffered by the insurer within one (1) year before the filing of a successful petition for liquidation under this act, the effect of which transfer may be to enable the creditor to obtain a greater percentage of this debt than another creditor of the same

class would receive. If a liquidation order is entered while the insurer is already subject to a rehabilitation order, then such transfers shall be deemed preferences if made or suffered within one (1) year before the filing of the successful petition for rehabilitation or within two (2) years before the filing of the successful petition for liquidation, whichever time is shorter.

(b) Any preference may be avoided by the liquidator if:

1. The insurer was insolvent at the time of the transfer;

2. The transfer was made within four (4) months before the filing of the petition;

3. The creditor receiving it or to be benefited thereby or his agent acting with reference thereto had, at the time when the transfer was made, reasonable cause to believe that the insurer was insolvent or was about to become inslovent; or

4. The creditor receiving it was an officer, or any employee or attorney or other person who was in fact in a position of comparable influence in the insurer to an officer whether or not he held such position, or any shareholder holding directly or indirectly more than five per cent (5%) of any class of any equity security issued by the insurer, or any other person, firm, corporation, association, or aggregation of persons with whom the insurer did not deal at arm's length.

(c) Where the preference is voidable, the liquidator may recover the property or, if it has been converted, its value from any person who has received or converted the

property, except where a bona fide purchaser or lienor has given less than fair equivalent value, he shall have a lien upon the property to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the court may on due notice order the lien or title to be preserved for the benefit of the estate, in which event the lien or title shall pass to the liquidator.

(2) (a) A transfer of property other than real property shall be deemed to be made or suffered when it becomes so far perfected that no subsequent lien obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.

(b) A transfer of real property shall be deemed to be made or suffered when it becomes so far perfected that no subsequent bona fide purchaser from the insurer could obtain rights superior to the rights of the transferee.

(c) A transfer which creates an equitable lien shall not be deemed to be perfected if there are available means by which a legal lien could be created.

(d) A transfer not perfected prior to the filing of a petition for liquidation shall be deemed to be made immediately before the filing of the successful petition.

(e) The provisions of this subsection apply whether or not there are or were creditors who might have obtained liens or persons who might have become bona fide purchasers.

(3) (a) A lien obtainable by legal or equitable proceedings upon a simple contract is one arising in the ordinary course of such proceedings upon the entry or docketing of a judgment or decree, or upon attachment, garnish-

ment, execution, or like process, whether before, upon, or after judgment or decree and whether before or upon levy. It does not include liens which under applicable law are given a special priority over other liens which are prior in time.

(b) A lien obtainable by legal or equitable proceedings could become superior to the rights of a transferee, or a purchaser could obtain rights superior to the rights of a transferee within the meaning of subsection (2) of this section, if such consequences would follow only from the lien or purchase itself, or from the lien or purchase followed by any step wholly within the control of the respective lienholder or purchaser, with or without the aid of ministerial action by public officials. Such a lien could not, however, become superior and such a purchase could not create superior rights for the purpose of subsection (2) of this section, through any acts subsequent to the obtaining of such a lien or subsequent to such a purchase which require the agreement or concurrence of any third party or which require any further judicial action or ruling.

(4) A transfer of property for or on account of a new and contemporaneous consideration which is deemed under subsection (2) of this section, to be made or suffered after the transfer because of delay in perfecting it does not thereby become a transfer for or on account of an antecedent debt if any acts required by the applicable law to be performed in order to perfect the transfer as against liens or bona fide purchasers' rights are performed within twenty-one (21) days or any period expressly allowed by the law, whichever is less. A transfer to secure a future loan, if such a loan is actually made, or a transfer which becomes security for a future loan, shall have the same

effect as a transfer for or on account of a new and contemporaneous consideration.

(5) If any lien deemed voidable under subsection (1)(b) hereof has been dissolved by the furnishing of a bond or other obligation, the surety, which has been indemnified directly or indirectly by the transfer of or the creation of a lien upon any property of an insurer before the filing of a petition under this act which results in a liquidation order, the indemnifying transfer or lien shall also be deemed voidable.

(6) The property affected by any lien deemed voidable under subsections (1) and (5) of this section shall be discharged from such lien, and that property and any of the indemnifying property transferred to or for the benefit of a surety shall pass to the liquidator, except that the court may on due notice order any such lien to be preserved for the benefit of the estate and the court may direct that such conveyance be executed as may be proper or adequate to evidence the title of the liquidator.

(7) The district court shall have summary jurisdiction of any proceeding by the liquidator to hear and determine the rights of any parties under the provisions of this section. Reasonable notice of any hearing in the proceeding shall be given to all parties in interest, including the obligee of a releasing bond or other like obligation. Where an order is entered for the recovery of indemnifying property in kind or for the avoidance of an indemnifying lien, the court, upon application of any party in interest, shall in the same proceeding ascertain the value of the property or lien; and if the value is less than the amount for which the property is indemnified or than the amount of the lien, the transferee

or lienholder may elect to retain the property or lien upon payment of its value, as ascertained by the court, to the liquidator, within such reasonable times as the court shall fix.

(8) The liability of a surety under a releasing bond or other like obligation shall be discharged to the extent of the value of the indemnifying lien nullified and voided by the liquidator, or where the property is retained under subsection (7) of this section to the extent of the amount paid to the liquidator.

(9) If a creditor has been preferred, and afterward in good faith gives the insurer further credit without security of any kind, for the property which becomes a part of the insurer's estate, the amount of the new credit remaining unpaid at the time of the petition may be set off against the preference which would otherwise be recoverable from him.

(10) If an insurer shall, directly or indirectly, within four (4) months before the filing of a successful petition for liquidation under this act, or at any time in contemplation of a proceeding to liquidate it, pay money or transfer property to an attorney-at-law for services rendered or to be rendered, the transaction may be examined by the court on its own motion or shall be examined by the court on petition of the liquidator and shall be held valid only to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the liquidator for the benefit of the estate, provided that where the attorney is in a position of influence in the insurer or an affiliate thereof, payment of any money or the transfer of any property to the attorney-at-law for services rendered or

to be rendered shall be governed by the provisions of subsection (1)(b)4 of this section.

(11) (a) Every officer, manager, employee, shareholder, member, subscriber, attorney, or any other person acting on behalf of the insurer who knowingly participates in giving any preference when he has reasonable cause to believe the insurer is or is about to become insolvent at the time of the preference shall be personally liable to the liquidator for the amount of the preference. It is permissible to infer that there is reasonable cause to so believe if the transfer was made within four (4) months before the date of filing of this successful petition for liquidation.

(b) Every person receiving any property from the insurer or the benefit thereof as a preference voidable under subsection (1) of this section shall be personally liable therefor and shall be bound to account to the liquidator.

(c) Nothing in this subsection shall prejudice any other claim by the liquidator against any person. [I.C., § 41-3328, as added by 1981, ch. 249, § 2, p. 502.]

41-3329. Claims of holders of void or voidable rights.—(1) No claims of a creditor who has received or acquired a preference, lien, conveyance, transfer, assignment, or encumbrance, voidable under this act, shall be allowed unless he surrenders the preference, lien, conveyance, transfer, assignment or encumbrance. If the avoidance is effected by a proceeding in which a final judgment has been entered, the claim shall not be allowed unless the money is paid or the property is delivered to the liquidator within thirty (30) days from the

date of the entering of the final judgment, except that the court having jurisdiction over the liquidation may allow further time if there is an appeal or other continuation of the proceeding.

(2) A claim allowable under subsection (1) of this section by reason of the avoidance, whether voluntary or involuntary, or a preference, lien, conveyance, transfer, assignment, or encumbrance, may be filed as an excused late filing under section 41-3335, Idaho Code, if filed within thirty (30) days from the date of the avoidance, or within the further time allowed by the court under subsection (1) hereof. [I.C., § 41-3329, as added by 1981, ch. 249, § 2, p. 502.]

41-3330. Setoffs and counterclaims.—(1) Mutual debts or mutual credits between the insurer and another person in connection with any action or proceeding under this act shall be set off and the balance only shall be allowed or paid, except as provided in subsection (2) hereof and section 41-3333, Idaho Code.

(2) No setoff or counterclaim shall be allowed in favor of any person where:

(a) The obligation of the insurer to the person would not at the date of the filing of a petition for liquidation entitle the person to share as a claimant in the assets of the insurer;

(b) The obligation of the insurer to the person was purchased by or transferred to the person with a view to its being used as a setoff;

(c) The obligation of the person is to pay an assessment levied against the members or subscribers of

the insurer, or is to pay a balance upon a subscription to the capital stock of the insurer, or is in any other way in the nature of a capital contribution; or

(d) The obligation of the person is to pay premiums whether earned or unearned, to the insurer. [I.C., § 41-3330, as added by 1981, ch. 249, § 2, p. 502.]

41-3331. Assessments.—(1) As soon as practicable but not more than two (2) years from the date of an order of liquidation under section 41-3318, Idaho Code, of an insurer issuing assessable policies, the liquidator shall make a report to the court setting forth:

(a) The reasonable value of the assets of the insurer;

(b) The insurer's probable total liabilities;

(c) The probable aggregate amount of the assessment necessary to pay all claims of creditors and expenses in full, including expenses of administration and costs of collecting the assessment; and

(d) A recommendation as to whether or not an assessment should be made and in what amount.

(2)(a) Upon the basis of the report provided in subsection (1) of this section, including any supplements and amendments thereto, the district court may levy one or more assessments against all members of the insurer who are subject to assessment.

(b) Subject to any applicable legal limits on assessability, the aggregate assessment shall be for the amount that the sum of the probable liabilities, the expenses of administration, and the estimated cost of collection of the assessment, exceeds the value of existing assets, with due regard being given to assessments that cannot be collected economically.

(3) After levy of assessment under subsection (2) of this section, the liquidator shall issue an order directing each member who has not paid the assessment pursuant to the order, to show cause why the liquidator should not pursue a judgment therefor.

(4) The liquidator shall give notice of the order to show cause by publication and by first class mail to each member liable thereunder, mailed to his last known address as it appears on the insurer's records, at least twenty (20) days before the return day of the order to show cause.

(5) (a) If a member does not appear and serve duly verified objections upon the liquidator on or before the return day of the order to show cause under subsection (3) hereof, the court shall make an order adjudging the member liable for the amount of the assessment against him, pursuant to subsection (3) hereof, together with costs, and the liquidator shall have a judgment against the member therefor.

(b) If on or before such return day, the member appears and serves duly verified objections upon the liquidator, the director may hear and determine the matter or may appoint a referee to hear it and make such order as the facts warrant. In the event that the director determines that such objections do not warrant relief from assessment, the member may request the court to review the matter and vacate the order to show cause.

(6) The liquidator may enforce any order or collect any judgment under subsection (5) of this section by any lawful means. [I.C., § 41-3331, as added by 1981, ch. 249, § 2, p. 502.]

41-3332. Reinsurer's liability.—The amount recoverable by the liquidator from reinsurers shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor shall not diminish the reinsurer's obligation to the insurer's estate except when the reinsurance contract provided for direct coverage of a named insured and the payment was made in discharge of that obligation. [I.C., § 41-3332, as added by 1981, ch. 249, § 2, p. 502.]

41-3333. Recovery of premiums owed.—(1) (a) An agent, broker, premium finance company, or any other person, other than the insured, responsible for the payment of a premium shall be obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency as shown on the records of the insurer. The liquidator shall also have the right to recover from such person any part of an unearned premium that represents commission of such person.

(b) An insured shall be obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer. [I.C., § 41-3333, as added by 1981, ch. 249, § 2, p. 502.]

41-3334. Domiciliary liquidator's proposal to distribute assets.—(1) Within one hundred twenty (120) days of a final determination of insolvency of an insurer by a court of competent jurisdiction of this state, the liquidator shall make application to the court for approval of a proposal to disburse assets out of marshaled assets, from time to time as such assets become available, to a guaranty association or foreign guaranty association having obligations

because of such insolvency. If the liquidator determines that there are insufficient assets to disburse, the application required by this section shall be considered satisfied by a filing by the liquidator stating the reasons for this determination.

(2) Such proposal shall at least include provisions for:

(a) Reserving amounts for the payment of expenses of administration and the payment of claims of secured creditors, to the extent of the value of the security held, and claims falling within the priorities established in section 41-3342, Idaho Code, classes 1 and 2;

(b) Disbursement of the assets marshaled to date and subsequent disbursement of assets as they become available;

(c) Equitable allocation of disbursements to each of the guaranty associations and foreign guaranty associations entitled thereto;

(d) The securing by the liquidator from each of the associations entitled to disbursements pursuant to this section of an agreement to return to the liquidator such assets, together with income earned on assets previously disbursed, as may be required to pay claims of secured creditors and claims falling within the priorities established in section 41-3342, Idaho Code, in accordance with such priorities. No bond shall be required of any such association; and

(e) A full report to be made by each association to the liquidator accounting for all assets so disbursed to the association, all disbursements made therefrom, any interest earned by the association on such assets and any other matter as the court may direct.

(3) The liquidator's proposal shall provide for disbursements to the associations in amounts estimated at least equal to the claim payments made or to be made thereby for which such associations could assert a claim against the liquidator, and shall further provide that if the assets available for disbursement from time to time do not equal or exceed the amount of such claim payments made or to be made by the association, then disbursements shall be in the amount of available assets.

(4) The liquidator's proposal shall, with respect to an insolvent insurer writing life or health insurance or annuities, provide for disbursements of assets to any guaranty association or any foreign guaranty association covering life or health insurance or annuities or to any other entity or organization reinsuring, assuming, or guaranteeing policies or contracts of insurance under the acts creating such associations.

(5) Notice of such application shall be given to the association in and to the directors of the department of insurance of each of the states. Any such notice shall be deemed to have been given when deposited in the United States certified mails, first class postage prepaid, at least thirty (30) days prior to submission of such application to the court. Action on the application may be taken by the court provided the above required notice has been given and provided further that the liquidator's proposal complies with subsection (2)(a) and (2)(b) of this section. [I.C., § 41-3334, as added by 1981, ch. 249, § 2, p. 502.]

41-3335. Filing of claims.—(1) Proof of all claims shall be filed with the liquidator in the form required by section 41-3336, Idaho Code, on or before the last

day for filing specified in the notice required under section 41-3322, Idaho Code, except that proof of claims for cash surrender values or other investment values in life insurance and annuities need not be filed unless the liquidator expressly so requires.

(2) The liquidator may permit a claimant making a late filing to share in distributions, whether past or future, as if he were not late, to the extent that any such payment will not prejudice the orderly administration of the liquidation, under the following circumstances:

(a) The existence of the claim was not known to the claimant and that he filed his claim as promptly thereafter as reasonably possible after learning of it;

(b) A transfer to a creditor was avoided under sections 41-3326 through 41-3328, Idaho Code, or was voluntarily surrendered under section 41-3329, Idaho Code, and that the filing satisfies the conditions of section 41-3329, Idaho Code; and

(c) The valuation under section 41-3341, Idaho Code, of security held by a secured creditor shows a deficiency, which is filed within thirty (30) days after the valuation.

(3) The liquidator shall permit late filing claims to share in distributions, whether past or future, as if they were not late, if such claims are claims of a guaranty association or foreign guaranty association for reimbursement of covered claims paid or expenses incurred, or both, subsequent to the last day for filing where such payments were made and expenses incurred as provided by law.

(4) The liquidator may consider any claim filed late which is not covered by subsection (2) of this section, and permit it to receive distributions which are subsequently declared on any claims of the same or lower priority if the payment does not prejudice the orderly administration of the liquidation. The late filing claimant shall receive, at each distribution, the same percentage of the amount allowed on his claim as is then being paid to claimants of any lower priority. This shall continue until his claim has been paid in full. [I.C., § 41-3335, as added by 1981, ch. 249, § 2, p. 502.]

41-3336. Proof of claim.—(1) Proof of claim shall consist of a statement signed by the claimant that includes all of the following that are applicable:

(a) The particulars of the claim including the consideration given for it;

(b) The identity and amount of the security on the claim;

(c) The payments made on the debt, if any;

(d) That the sum claimed is justly owing and that there is not setoff, counterclaim, or defense to the claim;

(e) Any right of priority of payment or other specific right asserted by the claimants;

(f) A copy of the written instrument which is the foundation of the claim; and

(g) The name and address of the claimant and the attorney who represents him, if any.

(2) No claim need be considered or allowed if it does not contain all the information in subsection (1) of this section, which may be applicable. The liquidator may require that a prescribed form be used, and may require that other information and document be included.

(3) At any time the liquidator may request the claimant to present information or evidence supplementary to that required under subsection (1) of this section and may take testimony under oath, require production of affidavits or depositions, or otherwise obtain additional information or evidence.

(4) No judgment or order against an insured or the insurer entered after the date of filng of a successful petition for liquidation, and no judgment or order against an insured or the insurer entered at any time by default or by collusion need be considered as evidence of liability or of quantum of damages. No judgment or order against an insured or the insurer entered within four (4) months before the filing of the petition need be considered as evidence of liability or of the quantum of damages.

(5) All claims of a guaranty association or foreign guaranty association shall be in such form and contain such substantiation as may be agreed to by the association and the liquidator. [I.C., § 41-3336, as added by 1981, ch. 249, § 2, p. 502.]

41-3337. Special claims.—(1) The claim of a third party which is contingent only on his first obtaining a judgment against the insured shall be considered and allowed as if there were no such contingency.

(2) A claim may be allowed even if contingent, if it is filed in accordance with section 41-3335, Idaho Code.

It may be allowed and may participate in all distributions declared after it is filed to the extent that it does not prejudice the orderly administration of the liquidation.

(3) Claims that are due except for the passage of time shall be treated as absolute claims are treated, except that such claims may be discounted at the legal rate of interest.

(4) Claims made under employment contracts by directors, principal officers, or persons in fact performing similar functions or having similar powers are limited to payment for services rendered prior to the issuance of any order of rehabilitation or liquidation under sections 41-3313 or 41-3318, Idaho Code. [I.C., § 41-3337, as added by 1981, ch. 249, § 2, p. 502.]

41-3338. Special provisions for third party claims.— (1) Whenever any third party asserts a cause of action against an insured of an insured in liquidation, the third party may file a claim with the liquidator.

(2) Whether or not the third party files a claim, the insured may file a claim on his own behalf in the liquidation. If the insured fails to file a claim by the date for filing claims specified in the order of liquidation or within sixty (60) days after mailing of the notice required by section 41-3322, Idaho Code, whichever is later, he is an unexcused late filer.

(3) The liquidator shall make his recommendations to the court under section 41-3342, Idaho Code, for the allowance of an insured's claim under subsection (2) of this section after consideration of the probable outcome of any pending action against the insured on which the claim is based, the probable damages recoverable in the action

and the probable costs and expenses of defense. After allowance by the court, the liquidator shall withhold any dividends payable on the claim, pending the outcome of litigation and negotiation with the insured. Whenever it seems appropriate, he shall reconsider the claim on the basis of additional information and amend his recommendations to the court. The insured shall be afforded the same notice and opportunity to be heard on all changes in the recommendation as in its initial determination. The court may amend its allowance as it thinks appropriate. As claims against the insured are settled or barred, the insured shall be paid from the amount withheld the same percentage dividend as was paid on other claims of like property, based on the lesser of:

(a) The amount actually recovered from the insured by action or paid by agreement plus the reasonable costs and expenses of defense; or

(b) The amount allowed on the claims by the court. After all claims are settled or barred, any sum remaining from the amount withheld shall revert to the undistributed assets of the insurer. Delay in final payment under this subsection shall not be a reason for unreasonable delay of final distribution and discharge of the liquidator.

(4) If several claims founded upon one (1) policy are filed, whether by third parties or as claims by the insured under this section, and the aggregate allowed amount of the claims to which the same limit of liability in the policy is applicable exceeds that limit, each claim as allowed shall be reduced in the same proportion so that the total equals the policy limit. Claims by the insured shall be evaluated as in subsection (3) of this sec-

tion. If any insured's claim is subseqently reduced under subsection (3) of this section, the amount thus freed shall be apportioned ratably among the claims which have been reduced under this subsection.

(5) No claim may be presented under this section if it is or may be covered by any guaranty association or foreign guaranty association. [I.C., § 41-3338, as added by 1981, ch. 249, § 2, p. 502.]

41-3339. Disputed claims.—(1) When a claim is denied in whole or in part by the liquidator, written notice of the determination shall be given to the claimant or his attorney by first class mail at the address shown in the proof of claim. Within sixty (60) days from the mailing of the notice, the claimant may file his objections with the liquidator. If no such filing is made the claimant may not further object to the determination.

(2) Whenever objections are filed with the liquidator and the liquidator does not alter his denial of the claim as a result of the objections, the liquidator shall ask the court for a hearing as soon as practicable and give notice of the hearing by first class mail to the claimant or his attorney and to any other persons directly affected, not less than ten (10) nor more than thirty (30) days before the date of the hearing. The matter may be heard by the court or by a court-appointed referee who shall submit findings of fact along with his recommendation. [I.C., § 41-3339, as added by 1981, ch. 249, § 2, p. 502.]

41-3340. Claims of surety.—Whenever a creditor whose claim against an insurer is secured, in whole or in part, by the undertaking of another person, fails to prove and file that claim, the other person may do so

in the creditor's name, and shall be subrogated to the rights of the creditor, whether the claim has been filed by the creditor or by the other person in the creditor's name, to the extent that he discharges the undertaking. In the absence of an agreement with the creditor to the contrary, the other person shall not be entitled to any distribution, however, until the amount paid to the creditor on the undertaking plus the distributions paid on the claim from the insurer's estate to the creditor equals the amount of the entire claim of the creditor. Any excess received by the creditor shall be held by him in trust for such other person. The term "other person" as used in this section is not intended to apply to a guaranty association or foreign guaranty association. [I.C., § 41-3340, as added by 1981, ch. 249, § 2, p. 502.]

41-3341. Secured creditor's claims.—(1) The value of any security held by a secured creditor shall be determined in one (1) of the following ways, as the court may direct:

(a) By converting the same into money according to the terms of the agreement pursuant to which the security was delivered to such creditors; or

(b) By agreement, arbitration, compromise or litigation between the creditor and the liquidator.

(2) The determination shall be under the supervision and control of the court with due regard for the recommendation of the liquidator. The amount so determined shall be credited upon the secured claim, and any deficiency shall be treated as an unsecured claim. If the claimant shall surrender his security to the liquidator, the entire claim shall be allowed as if unsecured. [I.C., § 41-3341, as added by 1981, ch. 249, § 2, p. 502.]

41-3342. Priority of distribution.—The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims as herein set forth. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(1) Class 1. The costs and expenses of administration, including, but not limited to, the following:

(a) The actual and necessary costs of preserving or recovering the assets of the insurer;

(b) Compensation for all services rendered in the liquidation;

(c) Any necessary filing fees;

(d) The fees and mileage payable to witnesses;

(e) Reasonable attorney's fees; and

(f) The reasonable expenses of a guaranty association or foreign guaranty association in handling claims.

(2) Class 2. Debts due to employees for services performed and benefits accrued to the extent that they do not exceed one thousand dollars ($1,000) and represent payment for services performed within one (1) year before the commencing of delinquency proceedings. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority which may be authorized by law as to wages or compensation of employees.

(3) Class 3. All claims under policies for losses incurred, including third party claims, all claims against

the insurer for liability for bodily injury or for injury to or destruction of tangible property which are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life and annuity policies, whether for death proceeds, annuity proceeds, or investment values shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to his employee shall be treated as a gratuity.

(4) Class 4. Claims under nonassessable policies for unearned premium of other premium refunds and claims of general creditors.

(5) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be postponed to the class of claims under subsection (8) of this section.

(6) Class 6. Claims filed late or any other claims other than claims under subsections (7) and (8) of this section.

(7) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies.

Payments to members of domestic mutual insurance companies shall be limited in accordance with law.

(8) Class 8. The claims of shareholders or other owners. [I.C., § 41-3342, as added by 1981, ch. 249, § 2, p. 502.]

41-3343. Liquidator's recommendations to the court. —(1) The liquidator shall review all claims duly filed in the liquidation and shall make such further investigation as he shall deem necessary. He may compound, compromise or in any other manner negotiate the amount for which claims will be recommended to the court except where the liquidator is required by law to accept claims as settled by any person or organization, including any guaranty association or foreign guaranty association. Unresolved disputes shall be determined under section 41-3339, Idaho Code. As soon as practicable, he shall present to the court a report of the claims against the insurer with his recommendations. The report shall include the name and address of each claimant and the amount of the claim finally recommended, if any. If the insurer has issued annuities or life insurance policies, the liquidator shall report the persons to whom, according to the records of the insurer, amounts are owed as cash surrender values or other investment value and the amounts owed.

(2) The court may approve, disapprove, or modify, the report on claims by the liquidator. Such reports as are not modified by the court within a period of sixty (60) days following submission by the liquidator shall be treated by the liquidator as allowed claims, subject thereafter to later modification or to rulings made by the court pursuant to section 41-3339, Idaho Code. No claim under a policy of insurance shall be allowed for an amount in

excess of the applicable policy limits. [I.C., § 41-3343, as added by 1981, ch. 249, § 2, p. 502.]

41-3344. Distribution of assets.—Under the direction of the court, the liquidator shall pay distributions in a manner that will assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims, including third party claims. Distribution of assets in kind may be made at valuations set by agreement between the liquidator and the creditor and approved by the court. [I.C., § 41-3344, as added by 1981, ch. 249, § 2, p. 502.]

41-3345. Unclaimed and withheld funds.—(1) All unclaimed funds subject to distribution remaining in the liquidator's hands when he is ready to apply to the court for discharge, including the amount distributable to any creditor, shareholder, member, or other person who is unknown or cannot be found, shall be deposited with the state treasurer, and shall be paid without interest except in accordance with section 41-3342, Idaho Code, to the person entitled thereto or his legal representative upon proof satisfactory to the state treasurer of his right thereto. Any amount on deposit not claimed within six (6) years from discharge of the liquidator shall be deemed to have been abandoned and shall be escheated without formal escheat proceedings and be deposited with the tax collector pursuant to chapter 5, title 14, Idaho Code.

(2) All funds withheld under section 41-3337, Idaho Code, and not distributed shall upon discharge of the liquidator be deposited with the state treasurer and paid by him in accordance with section 41-3342, Idaho Code.

Any sums remaining which under section 41-3342, Idaho Code, would revert to the undistributed assets of the insurer shall be transferred to the state treasurer and become the property of the state under subsection (1) hereof, unless the director in his discretion petitions the court to reopen the liquidation under section 41-3347, Idaho Code. [I.C., § 41-3345, as added by 1981, ch. 249, § 2, p. 502.]

41-3346. Termination of proceedings.—(1) When all assets justifying the expense of collection and distribution have been collected and distributed under this act, the liquidator shall apply to the court for discharge. The court may grant the discharge and make any other orders, including an order to transfer any remaining funds that are not economical to distribute, as may be deemed appropriate.

(2) Any other person may apply to the court at any time for an order under subsection (1) hereof. If the application is denied, the applicant shall pay the costs and expenses of the liquidator in resisting the application, including a reasonable attorney's fee. [I.C., § 41-3346, as added by 1981, ch. 249, § 2, p. 502.]

41-3347. Reopening liquidation.—After the liquidation proceeding has been terminated and the liquidator discharged, the director or other interested party may at any time petition the district court to reopen the proceedings for good cause, including the discovery of additional assets. If the court is satisfied that there is justification for reopening, it shall so order. [I.C., § 41-3347, as added by 1981, ch. 249, § 2, p. 502.]

41-3348. Disposition of records during and after termination of liquidation.—Whenever it shall appear to the director that the records of any insurer in process of liquidation or completely liquidated are no longer useful, he may recommend to the court and the court shall direct what records should be retained for future reference and what should be destroyed. [I.C., § 41-3348, as added by 1981, ch. 249, § 2, p. 502.]

41-3349. External audit of the receiver's books.—The district court may, as it deems desirable, cause audits to be made of the books of the director relating to any receivership established under this act, and a report of each audit shall be filed with the director and with the court. The books, records, and other documents of the receivership shall be made available to the auditor at any time without notice. The expense of each audit shall be considered a cost of administration of the receivership. [I.C., § 41-3349, as added by 1981, ch. 249, § 2, p. 502.]

41-3350. Conservation of property of foreign or alien insurers found in this state.—(1) If a domiciliary liquidator has not been appointed, the director may apply to the district court by verified petition for an order directing him to act as conservator to conserve the property of an alien insurer not domiciled in this state or a foreign insurer on any one or more of the following grounds:

(a) Any of the grounds in section 41-3312, Idaho Code;

(b) That any of its property has been sequestered by official action in its domiciliary state, or in any other state;

(c) That enough of its property has been sequestered in a foreign country to give reasonable cause to fear that the insurer is or may become insolvent;

(d) (i) That its certificate of authority to do business in this state has been revoked or that none was ever issued; and

(ii) That there are residents of this state with outstanding claims or outstanding policies.

(2) When an order is sought under subsection (1) of this section, the court shall cause the insurer to be given such notice and time to respond thereto as is reasonable under the circumstances.

(3) The court may issue the order in whatever terms it shall deem appropriate. The filing or recording of the order with the clerk of the district court or the recorder of deeds of the county in which the principal business of the company is located or the county in which its principal office or place of business is located, shall impart the same notice as a deed, bill of sale, or other evidence of title duly filed or recorded with that recorder of deeds would have imparted.

(4) The conservator may at any time petition for and the court may grant an order under section 41-3351, Idaho Code, to liquidate assets of a foreign or alien insurer under conservation, or, if appropriate, for an order under section 41-3353, Idaho Code, to be appointed ancillary receiver.

(5) The conservator may at any time petition the court for an order terminating conservation of an insurer. If the court finds that the conservation is no longer necessary, it shall order that the insurer be restored to possession of its property and the control of its business. The court

may also make such finding and issue such order at any time upon motion of any interested party, but if such motion is denied all costs shall be assessed against such party. [I.C., § 41-3350, as added by 1981, ch. 249, § 2, p. 502.]

41-3351. Liquidation of property of foreign or alien insurers found in this state.—(1) If no domiciliary receiver has been appointed, the director may apply to the district court by verified petition for an order directing him to liquidate the assets found in this state of a foreign insurer or an alien insurer not domiciled in this state, on any of the following grounds:

(a) Any of the grounds in sections 41-3312 or 41-3317, Idaho Code; or

(b) Any of the grounds specified in sections 41-3350 (1)(b) through (d), Idaho Code.

(2) When an order is sought under subsection (1) of this section, the court shall cause the insurer to be given such notice and time to respond thereto as is reasonable under the circumstances.

(3) If it shall appear to the court that the best interests of creditors, policyholders, and the public require, the court may issue an order to liquidate in whatever terms it shall deem appropriate. The filing or recording of the order with the clerk of the district court or the recorder of deeds of the county in which the principal business of the company is located or the county in which its principal office or place of business is located, shall impart the same notice as a deed, bill of sale, or other evidence of title duly filed or recorded with that recorder of deeds would have imparted.

(4) If a domiciliary liquidator is appointed in a reciprocal state while a liquidation is proceeding under the provisions of this section, the liquidator, under the provisions of this section, shall thereafter act as ancillary receiver under section 41-3353, Idaho Code. If a domiciliary liquidator is appointed in a nonreciprocal state while a liquidation is proceeding under the provisions of this section, the liquidator, under the provisions of this section, may petition the court for permission to act as ancillary receiver under section 41-3353, Idaho Code.

(5) On the same grounds as are specified in subsection (1) of this section, the director may petition any appropriate federal district court to be appointed receiver to liquidate that portion of the insurer's assets and business over which the court will exercise jurisdiction, or any lesser part thereof that the director deems desirable for the protection of the policyholders and creditors in this state.

(6) The court may order the director, when he has liquidated the assets of a foreign or alien insurer under this section, to pay claims of residents of this state against the insurer under such rules as to the liquidation of insurers under this act as are otherwise compatible with the provisions of this section. [I.C., § 41-3351, as added by 1981, ch. 249, § 2, p. 502.]

41-3352. Domiciliary liquidators in other states.—(1) The domiciliary liquidator of an insurer domiciled in a reciprocal state shall, except as to special deposits and security on secured claims under section 41-3353(3), Idaho Code, be vested by operation of law with the title to all of the assets, property, contracts, and rights of action, agents' balances, and all of the books, accounts

and other records of the insurer located in this state. The date of vesting shall be the date of the filing of the petition, if that date is specified by the domiciliary law for the vesting of property in the domiciliary state. Otherwise, the date of vesting shall be the date of entry of the order directing possession to be taken. The domiciliary liquidator shall have the immediate right to recover balances due from agents and to obtain possession of the books, accounts and other records of the insurer located in this state. He also shall have the right to recover all other assets of the insurer located in this state, subject to section 41-3353, Idaho Code.

(2) If a domiciliary liquidator is appointed for an insurer not domiciled in a reciprocal state, the director of this state shall be vested by operation of law with the title to all of the property, contracts and rights of action, and all of the books, accounts and other records of the insurer located in this state, at the same time that the domiciliary liquidator is vested with title in the domicile. The director of this state may petition for a conservation or liquidation order under sections 41-3350 and 41-3351, Idaho Code, or for an ancillary receivership under section 41-3353, Idaho Code, or after approval by the district court may transfer title to the domiciliary liquidator, as the interests of justice and the equitable distribution of the assets require.

(3) Claimants residing in this state may file claims with the liquidator or ancillary receiver, if any, in this state or with the domiciliary liquidator, if the domiciliary law permits. The claims must be filed on or before the last date fixed for the filing of claims in the domiciliary liquidation proceedings. [I.C., § 41-3352, as added by 1981, ch. 249, § 2, p. 502.]

41-3353. Ancillary formal proceedings.—(1) If a domiciliary liquidator has been appointed for an insurer not domiciled in this state, the director may file a petition with the district court requesting appointment as ancillary receiver in this state:

(a) If he finds that there are sufficient assets of the insurer located in this state to justify the appointment of an ancillary receiver; and

(b) If the protection of creditors or policyholders in this state so requires.

(2) The court may issue an order appointing an ancillary receiver in whatever terms it shall deem appropriate. The filing or recording of the order with the recorder of deeds in this state imparts the same notice as a deed, bill of sale, or other evidence of title duly filed or recorded with that recorder of deeds.

(3) When a domiciliary liquidator has been appointed in a reciprocal state, then the ancillary receiver appointed in this state may, whenever necessary, aid and assist the domiciliary liquidator in recovering assets of the insurer located in this state. The ancillary receiver shall, as soon as practicable, liquidate from their respective securities those special deposit claims and secured claims which are proved and allowed in the ancillary proceedings in this state, and shall pay the necessary expenses of the proceedings. He shall promptly transfer all remaining assets, books, accounts and records to the domiciliary liquidator. Subject to this section, the ancillary receiver and his deputies shall have the same powers and be subject to the same duties with respect to the administration of assets as a liquidator of an insurer domiciled in this state.

(4) When a domiciliary liquidator has been appointed in this state, ancillary receivers appointed in reciprocal states shall have, as to assets and books, accounts, and other records in their respective states, corresponding rights, duties and powers to those provided in subsection (3) of this section for ancillary receivers appointed in this state. [I.C., § 41-3353, as added by 1981, ch. 249, § 2, p. 502.]

41-3354. Ancillary summary proceedings.—The director in his sole discretion may institute proceedings under sections 41-3339 through 41-3311 [41-3341], Idaho Code, at the request of the director or other appropriate insurance official of the domiciliary state of any foreign or alien insurer having property located in this state. [I.C., § 41-3354, as added by 1981, ch. 249, § 2, p. 502.]

41-3355. Claims of nonresidents against insurers domiciled in this state.—(1) In a liquidation proceeding begun in this state against an insurer domiciled in this state, claimants residing in foreign countries or in states not reciprocal, states must file claims in this state, and claimants residing in reciprocal states may file claims either with the ancillary receivers, if any, in their respective states, or with the domiciliary liquidator. Claims must be filed on or before the last date fixed for the filing of claims in the domiciliary liquidation proceeding.

(2) Claims belonging to claimants residing in reciprocal states may be proved either in the liquidation proceeding in this state as provided in this act, or in ancillary proceedings, if any, in the reciprocal states. If notice of the claims and opportunity to appear and be heard is afforded the domiciliary liquidator of this

state as provided in section 41-3356(2), Idaho Code, with respect to ancillary proceedings, the final allowance of claims by the courts in ancillary proceedings in reciprocal states shall be conclusive as to amount and as to priority against special deposits or other security located in such ancillary states, but shall not be conclusive with respect to priorities against general assets under section 41-3342, Idaho Code. [I.C., § 41-3355, as added by 1981, ch. 249, § 2, p. 502.]

41-3356. Claims of residents against insurers domiciled in reciprocal states.—(1) In a liquidation proceeding in a reciprocal state against an insurer domiciled in that state, claimants against the insurer who reside within this state may file claims either with the ancillary receiver, if any, in this state, or with the domiciliary liquidator. Claims must be filed on or before the last dates fixed for the filing of claims in the domiciliary liquidation proceeding.

(2) Claims belonging to claimants residing in this state may be proved either in the domiciliary state under the law of that state, or in ancillary proceedings, if any, in this state. If a claimant elects to prove his claim in this state, he shall file his claim with the liquidator in the manner provided in sections 41-3335 and 41-3336, Idaho Code. The ancillary receiver shall make his recommendation to the court as under section 41-3343, Idaho Code. He shall also arrange a date for hearing if necessary under section 41-3339, Idaho Code, and shall give notice to the liquidator in the domiciliary state, either by certified mail or by personal service at least forty (40) days prior to the date set for hearing. If the domiciliary liquidator, within thirty (30) days after the giving of such notice, gives notice in writing to the ancillary re-

ceiver and to the claimant, either by certified mail or by personal service, of his intention to contest the claim, he shall be entitled to appear or to be represented in any proceeding in this state involving the adjudication of the claim.

(3) The final allowance of the claim by the courts of this state shall be accepted as conclusive as to amount and as to priority against special deposits or other security located in this state. [I.C., § 41-3356, as added by 1981, ch. 249, § 2, p. 502.]

41-3357. Attachment, garnishment, and levy of execution.—During the pendency in this or any other state of a liquidation proceeding, whether called by that name or not, no action or proceeding in the nature of an attachment, garnishment, or levy of execution shall be commenced or maintained in this state against the delinquent insurer or its assets. [I.C., § 41-3357, as added by 1981, ch. 249, § 2, p. 502.]

41-3358. Interstate priorities.—(1) In a liquidation proceeding in this state involving one or more reciprocal states, the order of distribution of the domiciliary state shall control as to all claims of residents of this and reciprocal states. All claims of residents of reciprocal states shall be given equal priority of payment from general assets regardless of where such assets are located.

(2) The owners of special deposit claims against an insurer for which a liquidator is appointed in this or any other state shall be given priority against the special deposits in accordance with the statutes governing the creation and maintenance of the deposits. If there is a deficiency in any deposit, so that the claims secured by it are not fully discharged from it, the claimants may

share in the general assets, but the sharing shall be deferred until general creditors, and also claimants against other special deposits who have received smaller percentages from their respective special deposits, have been paid percentages of their claims equal to the percentage paid from the special deposit.

(3) The owner of a secured claim against an insurer for which a liquidator has been appointed in this or any other state may surrender his security and file his claim as a general creditor, or the claim may be discharged by resort to the security in accordance with section 41-3341, Idaho Code, in which case the deficiency, if any, shall be treated as a claim against the general assets of the insurer on the same basis as claims of unsecured creditors. [I.C., § 41-3358, as added by 1981, ch. 249, § 2, p. 502.]

41-3359. Subordination of claims for noncooperation. —If an ancillary receiver in another state or foreign country, whether called by that name or not, fails to transfer to the domiciliary liquidator in this state any assets within his control other than special deposits, diminished only by the expenses of the ancillary receivership, if any, the claims filed in the ancillary receivership, other than special deposit claims or secured claims, shall be placed in the class of claims under section 41-3342(7), Idaho Code. [I.C., § 41-3359, as added by 1981, ch. 249, § 2, p. 502.]

41-3360. Severability.—If any provision of this act or the application thereof to any person or circumstance is for any reason held to be invalid, the remainder of the act and the application of such provision to other persons or circumstances shall not be affected thereby. [I.C., § 41-3360, as added by 1981, ch. 249, § 2, p. 502.]

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No. 88-1265

In the Supreme Court of the United States

OCTOBER TERM, 1988

Anthony J. Fagiano, Director of the Department of Insurance; STATE OF IDAHO, as liquidator for Pacific Insurance Administrators, Inc., and Pacific Insurance Administrators Agency, Inc.,
Petitioners,

vs.

UNITED STATES OF AMERICA and the INTERNAL REVENUE SERVICE, et al.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTEREST OF THE AMICUS CURIAE

The National Association of Insurance Commissioners ("NAIC") is a nonprofit, unincorporated association whose membership consists of the 50 states, the District of Columbia, the territories and insular possessions of the United States. The NAIC was organized in 1871 to assure the protection of policyholders across the country. As stated in the NAIC's Constitution, the protection of policyholders continues to be the principal objective of the NAIC:

Article II. OBJECTIVE

The objective of this body is to serve the public by assisting the several State insurance supervisory officials, individually and collectively, in achieving the following fundamental insurance regulatory objectives:

(1) Maintenance and improvement of State regulation of insurance in a responsive and efficient manner;

(2) Reliability of the insurance institution as to financial solidity and guaranty against loss;

(3) Fair, just and equitable treatment of policyholders and claimants.

II *NAIC Proceedings* p. iii (1988).

The principal function of the NAIC is to serve the public by assisting these insurance commissioners in overseeing the activities of the insurance industry, which activities include the supervision of rehabilitation and liquidation proceedings.

Each commissioner is obligated by law to protect policyholders and in doing so, must carry out all applicable statutory procedures. At issue in this case is whether the Idaho statutory procedures setting forth a priority system for claims payment constitute statutes enacted for the purpose of regulating the "business of insurance" under the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.*,[1] and if so, whether this precludes application of the "super" priority set forth in 31 U.S.C. § 3713[2] to the claims in this liquidation.

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1. Appendix A.
2. Appendix B.

The Idaho statutes are derived from a model law developed by the NAIC, the Insurers Supervision, Rehabilitation and Liquidation Model Act, which has been adopted in some manner by every state. This model law places the claims of policyholders above those of the state or federal government. All states which have adopted this approach are significantly affected by the decision of the Ninth Circuit Court of Appeals and by the recent decision of the Fourth Circuit Court, both of which held that claims of the federal government must be placed ahead of policyholder claims. The individual state commissioners, the members of the NAIC, possess a vital interest in the outcome of this matter because the opinion has a significant impact on policyholders. The decision impairs the ability of the commissioners to fulfill the responsibility vested in them by law to wind up the affairs of insolvent insurance companies, which responsibility includes the paying of policyholder claims.

In submitting this brief, the NAIC seeks to demonstrate its interests in this proceeding, which are:

1. To preserve the orderly disbursement of assets of insolvent insurers,

2. To encourage cooperation and uniformity among states in the liquidation of insolvent insurers, and

3. To assist the state insurance commissioners in protecting the interests of policyholders across the country.

This brief is therefore submitted, with consent of the parties, in support of the petition of the State of Idaho as liquidator for Pacific Insurance Administrators, Inc. and Pacific Insurance Administrators Agency, Inc.

ARGUMENT

I. The Ninth Circuit's decision creates a significant nationwide impact on all state insurance commissioners in the administration or supervision of insolvent insurance companies.

A. The priority scheme for payment of claims which was developed by the NAIC has been widely adopted by the states.

In urging this Court to grant the liquidator's petition, the NAIC seeks to maintain the orderly and uniform distribution of the assets of insolvent insurers. The distribution process will be severely hampered if the Ninth Circuit's decision[3] stands because it will destroy the distribution approach taken by the majority of states.

Idaho's statutory scheme governing liquidation proceedings[4] is patterned after the Uniform Insurers Liquidation Act[5] which is similar to the NAIC Insurers Supervision, Rehabilitation and Liquidation Model Act. The majority of states have endorsed the priority scheme set forth in the NAIC model which places policyholder claims before

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3. *Idaho ex rel. Soward v. Internal Revenue Service*, 858 F.2d 445 (9th Cir. 1988).

4. Idaho Ins. Code § ch.33.

5. The Uniform Insurers Liquidation Act was prepared by the National Conference of Commissioners on Uniform State Laws in conjunction with the NAIC, the Insurance Law Section of the American Bar Association and various state insurance departments. It contains the same principles as the NAIC's model. The Insurers Supervision, Rehabilitation and Liquidation Model Act, Model No. 555, II *NAIC Model Laws, Regulations and Guidelines* (1989). The Uniform Act was intended to facilitate liquidation proceedings and to promote equitable distribution of the assets of defunct insurers. 13 Uniform Laws Annotated 323 (1986).

those of the federal government.[6] This endorsement of the priority scheme is significant because it reflects how fundamental the protection of policyholders is.

If the Ninth Circuit Court's decision is allowed to stand, it will directly impair the states' ability to pay policyholder claims. This impairment will extend nationwide, thereby depriving policyholders across the country of the protection afforded to them by the state priority of distribution laws.

The effect of the Ninth Circuit's opinion also extends to the personal liability of the commissioners as receivers or liquidators of insolvent companies because subsection (b) of 31 U.S.C. § 3713 subjects them to liability if they pay any debts before those of the federal government. The state insurance commissioners generally are obligated by law to appoint a receiver or liquidator to handle the affairs of a financially troubled or insolvent insurance company. The commissioners' responsibility does not conclude once a receiver or liquidator is appointed. The commissioner always maintains supervisory responsibility over the activities of the receiver or liquidator. Therefore, whether directly, or indirectly through appointment of a receiver or liquidator, the commissioner is ultimately the overseer of the company's affairs. The orderly administration of insolvent company affairs has already been thwarted in a number of instances because of the dilemma facing state commissioners as liquidators of the companies. The commissioners are faced with releasing assets of the company to pay claims of the federal government (in contraven-

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6. *See* Appendix C for the text of the priority scheme and Appendix D for a list of those states which have adopted this concept.

tion of the state statutory priority scheme and in disregard for the interests of policyholders) or refusing to release the funds (by obeying state law) and facing personal liability for failure to do so. Either of these alternatives is highly undesirable because the interests of the policyholders are ultimately affected. The policyholders face a delay in claims payment, and very likely no payment at all, as a result of the federal claim for priority.

B. The Ninth Circuit failed to take the philosophy of protecting policyholders into consideration when it rendered its decision.

Placing policyholder claims among those paid first coincides with the fundamental philosophy underlying state insurance regulation. That fundamental tenet is to protect the interests of policyholders. Protecting the interests of policyholders has historically been linked to the monitoring of company solvency. As the NAIC's constitution provides, "[t]he objective of this body is to serve the public by assisting the several State insurance supervisory officials . . . in achieving . . . (2) reliability of the insurance institution as to *financial solidity and guaranty against loss;* . . ." (Emphasis added.) II *NAIC Proceedings* p. iii (1988). The ability of a company to guaranty against loss depends on its financial solidity. That "guaranty against loss" is a protection purchased by a policyholder and it is something which the policyholder is entitled to expect, regardless of the company's financial position.

To carry out this fundamental objective of protecting the interests of policyholders, the insurance commissioners utilize statutory accounting principles, used only by in-

surance companies, to provide a "cushion" to protect the policyholder from the occasional, but sometimes inevitable insolvency. Distribution of the assets comprising this "cushion" is the very essence of state regulation.

In the event that a company becomes insolvent and is unable to fulfill its obligations to policyholders, the state steps in and attempts to fulfill those obligations to the extent possible under the law. The "laws" on liquidation originated decades ago. One of the bases for state laws on liquidation is the NAIC's model on liquidation of insurers.[7] This development of model legislation is one of the methods to encourage cooperation and uniformity among the states in the liquidation process, and it is intended to result in protection of policyholder interests. The Ninth Circuit Court failed to take this fundamental philosophy of protecting policyholders into consideration when it determined that the state's priority scheme for payment of claims is not the "business of insurance."

C. The Ninth Circuit's decision will affect a number of pending liquidation proceedings.

The issue presented in the liquidator's petition is one of widespread significance. It merits review by this Court because of the number of pending insurance company liquidations in which the question is or may become an issue. There are over 30 liquidations currently in process in which the federal priority question has already been or is likely to be raised. In these liquida-

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7. I *NAIC Proceedings* 30-32 (1936). The model was revised extensively in 1978 and continues to be updated. I *NAIC Proceedings* 238-290 (1978).

tions alone, it is estimated that over $30,000,000 in federal claims may be asserted pursuant to 31 U.S.C. § 3713. In several instances the assets of the insolvent company are insufficient to pay both the claims of the federal government and have anything remaining for policyholders and other insureds. In addition, the commissioners in all states are gravely impeded in their ability to proceed with an orderly distribution of assets until this matter is finally resolved. The ambiguity created by the Ninth Circuit's decision needs to be settled in order for these pending liquidation proceedings to move forward.

II. The Ninth Circuit Court erred in concluding that the Idaho priority scheme does not constitute regulation of the business of insurance under the McCarran-Ferguson Act.

The NAIC urges this Court to review the conclusion drawn by the Ninth Circuit that the Idaho scheme governing the priority for distributing assets of insolvent insurance companies does not constitute the business of insurance under the McCarran-Ferguson Act. Whether the members of the NAIC, the insurance commissioners, can continue to carry out their obligation of rehabilitating or liquidating companies is dependent on resolution of this issue. The states have long followed the mandate of the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.*, that the regulation of the business of insurance is vested in the states. A ruling that restricts the scope of state regulation of the business of insurance has a detrimental effect on the insurance commissioners' authority to administer the affairs of insolvent companies across the country.

Different circuits have drawn different conclusions on this same issue. The Ninth Circuit limited its ruling to the issue of whether the priority scheme, not the entire statutory scheme on rehabilitations and liquidations, constitutes the business of insurance. As a result, it appears that the state of Idaho maintains its authority to regulate insolvent insurance companies under Chapter 33 of the Idaho Insurance Code. However, the extent of this authority is not clear. Also, what is not clear is the manner in which assets are now to be distributed. If the priority scheme does not constitute the "business of insurance" under the Ninth Circuit's ruling, exactly how are the assets to be distributed? Without the benefit of the state priority statutes, it would appear that all creditors, including shareholders who may have contributed to the insolvency, would share equally with policyholders any assets remaining after the payment of federal government claims. The absence of a priority scheme creates numerous questions about the entitlement of others, not just shareholders.

The Fourth Circuit, on the other hand, did not limit its holding to the priority section of the Maryland statute at issue. It held that the entire liquidation scheme does not constitute the business of insurance under McCarran-Ferguson.[8] Under the Fourth Circuit Court's opinion, insurance commissioners will not only be forced to relegate payment of policyholder claims to those of the federal government, but their overall authority to administer the affairs of an insurance company is placed into question because of the ruling that these activities do not constitute the business of insurance under the McCarran-Ferguson Act.

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8. *Gordon v. United States Treasury*, 846 F.2d 272 (4th Cir. 1988), *cert. denied* 109 S.Ct. 390 (1988).

A disturbing aspect of these two circuit opinions is the basis on which the conclusions were drawn. The Ninth Circuit Court relied on *Securities and Exchange Comm'n v. National Securities*, 393 U.S. 453 (1969) to justify its decision that the Idaho priority scheme does not constitute the business of insurance while the Fourth Circuit applied the three-part test enunciated in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), to reach its conclusion that the Maryland statutory scheme does not constitute the business of insurance. Both articulate the meaning of "business of insurance," but for totally different purposes. In *Pireno*, the Court defines "business of insurance" for purposes of triggering the antitrust exemption of the McCarran-Ferguson Act[9] while the determination in *National Securities* was made for purposes other than antitrust. Direction from this Court is crucial in ascertaining the appropriate test for the business of insurance dilemma arising in cases under the McCarran-Ferguson Act.

Regardless of which test is the appropriate test, however, the NAIC maintains that the entire statutory scheme governing the rehabilitation and liquidation of insurance companies constitutes the business of insurance.

Under the three-part test set forth in *Pireno*, three factors are relevant: (1) whether the activity involves the transfer or spreading of risk, (2) whether it involves the relationship between an insurer and insured, and (3) whether the activity is confined to entities within the insurance industry.

1. Transfer or spreading of risk.

The most important factor to consider when analyzing this part of the test is that the policyholder's risk does

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9. 15 U.S.C. § 1013(b).

not automatically cease to exist when a company becomes insolvent. The liquidation of the company inextricably involves the payment of claims which this Court itself has recognized as the business of insurance.[10] Limiting the "spreading of risk" to the period preceding insolvency as the Ninth Circuit suggests does not coincide with the principal goal of state insurance regulation, which is the protection of policyholders. Undue hardship should therefore not be inflicted on the policyholders of an insolvent insurance company. The policyholder should not be burdened with the responsibility of ascertaining the financial condition of the company prior to the placing of his or her business with that company.

A state insurance commissioner undertakes an obligation of administering the affairs of a company if necessary, which may include supervision, rehabilitation or liquidation of the company's affairs. This duty exists from the moment a company receives authorization to conduct business in any given state and extends through the moment the business is finally resolved. The Ninth Circuit makes many references to the fact that the "insurer has ceased to "exist"[11] and that "the company [is] no longer involved in risk protection."[12] These references are inaccurate because the company's charter is not extinguished until the affairs of the company are finalized.

It is also important to note that, in addition to liquidations, rehabilitations are a significant component of a commissioner's duty. Rehabilitations are attempts to maintain the company's existence and do not involve dis-

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10. *Group Life and Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 213 (1979).

11. *Idaho ex rel. Soward v. Internal Revenue Service*, No. 87-4057, slip op. at 10930 (9th Cir. Sept. 7, 1988).

12. *Id.* at 10931.

solution of the company unless necessary. The statutes governing liquidations generally encompass rehabilitations as well, and in these situations the company has definitely not ceased to exist.

2. Relationship between the insurer and insured.

Because the insurer/policyholder relationship continues to exist until the affairs of the insolvent company are resolved, the second criteria of the *Pireno* test is satisfied also. The relationship between the insurer and insured/policyholder is specifically addressed in the NAIC model law governing liquidations and is addressed in every state statute governing this process. The fact that the states have anticipated and have prepared for the distribution of money to pay policyholder claims (by statute) demonstrates that the relationship between the insurer and policyholder continues to exist. The statutes were designed to insure that this insurer/policyholder relationship would be disrupted as little as possible in the event of insolvency.

3. Activity is confined to entities within the insurance industry.

Insurance company insolvencies are not governed by bankruptcy law, but by state insurance statutes governing liquidations and rehabilitations. *Universal Marine Ins. Co. v. Beacon Ins. Co.*, 768 F.2d 84, 88 (4th Cir. 1985). These state statutes are only designed to cover insurance company insolvency, and the authority vested therein is limited to the matters involving members of the insurance industry. The third criteria of *Pireno* is satisfied as well.

Finally, under the *National Securities* analysis, the Ninth Circuit incorrectly assumed that the company has ceased to exist and used this as the basis for concluding

that the priority scheme does not constitute the business of insurance. As explained above, the company has not ceased to exist until all of the affairs of the insolvent company have been concluded and this process involves the payment of claims to policyholders and other claimants, including the federal government.

III. The Ninth Circuit's decision conflicts with other decisions on the scope of the state commissioners' authority to rehabilitate or liquidate insolvent insurance companies.

Recent developments in the circuit courts have perpetuated the need for this Court to resolve the issue. Since this Court's denial of the petitioner's request in *Gordon v. United States Treasury*, yet another Circuit Court opinion has been rendered in *Lac D'Amiante Du Quebec, LTEE v. Am. Home Assurance Co.*, Nos. 87-5249, 87-5380, 87-5401 (3rd Cir. Dec. 28, 1988).[13] In *Lac D'Amiante*, the Third Circuit has reinforced the concept that the state's interest in regulating insolvent insurance companies is strong, that a complex regulatory scheme is in place to manage the rehabilitation or dissolution of companies and that the company's corporate charter does not cease to exist until the rehabilitation or liquidation process is complete.[14] Although the Third Circuit states that it did not specifically address McCarran-Ferguson preemption, its action in abstaining from asserting jurisdiction amounts to a deferral to state regulation. As the court explained, the Burford abstention doctrine stands for the proposition that federal courts should avoid needless disruption of an important, complex state regulatory

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13. 1988 U.S. App. Lexis 17590.

14. 1988 U.S. App. Lexis 17590.

scheme.[15] In this case, the Third Circuit went to great lengths to describe the extensive state regulatory scheme which exists and had little difficulty concluding that abstention was appropriate.

This recent Third Circuit decision is preceded by a similar conclusion in *Crist v. J. Henry Schroder Bank & Trust Co.*, 696 F. Supp. 981 (S.D. N.Y. 1988), and in *Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988),[16] which conclusions are diametrically opposed to the Fourth and Ninth Circuit analyses.

More federal decisions on this identical issue are forthcoming. Another example is an action pending in Ohio. *Fabe v. United States Treasury*, No. C2-88-778, United States District Court, Southern District of Ohio. This case involves the liquidation of American Druggists Insurance Company which issued surety bonds. Cross motions are pending on the issue of whether the Ohio statutes constitute the "business of insurance" under the McCarran-Ferguson Act. The Sixth Circuit may therefore be called upon to address the issue in the near future.

In summary, the recent Circuit Court decisions have done nothing but exacerbate the confusion which exists concerning the states' authority to supervise rehabilitations and liquidations, and this uncertainty can only be resolved by this Court.

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15. 1988 U.S. App. Lexis 17590, p.8.

16. Petition for Certiorari filed Jan. 11, 1989, No. 88-1155.

IV. Practical difficulties and dislocations which have resulted from the Ninth Circuit's opinion merit consideration by this Court.

The Ninth Circuit's holding that the federal priority supersedes the state priority scheme does not simply dispose of the federal claims nor does it dispose of the commissioners' possible personal liability. Although the Idaho liquidator apparently is directed to pay the federal government claims before those of policyholders pursuant to the Ninth Circuit opinion, he, as commissioner, is still obligated to uphold the state law. He cannot uphold the state law and carry out the directives set forth in the Ninth Circuit's decision. The two are inconsistent and place the commissioner in a difficult circumstance. Further, the Ninth Circuit's decision would not necessarily be binding in another circuit. Countrywide uniformity is far from being accomplished as a result of either the Ninth or Fourth Circuit opinions.

Assuming that as a result of the Ninth Circuit's decision payment would now be appropriate, the state liquidator and the federal government confront numerous issues such as the dates which would bar further claims, cancellation dates and filing dates for claims, for example. Even when dealing with federal government claims, a liquidator should be afforded some finality to payment of those claims. The liquidator must be assured that once he or she pays the claims, the liquidator cannot be held responsible for those which are asserted at a later date. In the event of disputes over these and other issues, is the federal government bound by decisions of the court which is adjudicating the receivership or liquidation?

Another obvious question which might arise is whether the insolvent estate is entitled to recover any administrative expenses before paying the federal government. This question is not contemplated by the Ninth Circuit's decision. Also not contemplated by the Ninth Circuit's opinion is the injustice caused in cases in which the assets are not sufficient to cover either the federal government claims or the policyholder claims. There is no flexibility built into the federal statute, 31 U.S.C. § 3713, and no direction is furnished in the Ninth Circuit's opinion as to how this situation will be handled.

Another significant concern is the procedure by which a liquidator would ascertain the extent of the federal government claims. If the liquidator notified the federal government that a liquidation is pending, to whom would the notices be sent? Would one notice be sufficient? Also added to these concerns are issues which include but are not limited to rescission of the policies, jurisdiction and venue.

In light of these few considerations alone, it is evident that the decisions of the Fourth and Ninth Circuits have created a regulatory void of uncertainty which can only be filled on an ad hoc basis. An ad hoc approach is not desirable for either the federal government or state liquidators because, among other things, it leads to increased litigation. The NAIC, therefore, respectfully requests that the Court consider these issues in determining whether to grant the liquidator's petition for writ of certiorari.

SUMMARY OF ARGUMENT

The NAIC vigorously supports the liquidator's petition to this Court requesting a clarification of the law concerning the application of the McCarran-Ferguson Act to state liquidation proceedings. Resolution of this issue is urgent in light of conflicting opinions on the same issue between the Fourth Circuit and the Ninth Circuit and between these two circuits and the Second and Tenth Circuits. Just as importantly, the practical difficulties and dislocations which are now facing liquidators nationwide as a result of these decisions point out a critical need for this Court to furnish guidance on these issues and to eliminate the regulatory void which has been created.

CONCLUSION

For the foregoing reasons, the NAIC respectfully requests that this Court grant the liquidator's petition for a writ of certiorari.

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APPENDIX

APPENDIX A

McCarran-Ferguson Act

Chapter 20. REGULATION OF INSURANCE

§ 1011. Declaration of policy

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by State law; Federal Law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§ 1013. Suspension until June 30, 1948, of application of certain Federal laws; Sherman Antitrust Act applicable to agreements to, or acts of, boycott, coercion, or intimidation

(a) Until June 30, 1948, the Act of July 2, 1980, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

§ 1014. Applicability of National Labor Relations Act and Fair Labor Standards Act of 1938

Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

§ 1015. Definition of "State"

As used in this chapter, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, Guam, and the District of Columbia.

APPENDIX B

31 U.S.C. § 3713

§ 3713. Priority of Government claims

(a)(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.

APPENDIX C

NAIC Insurers Supervision, Rehabilitation and Liquidation Model Act

Section 42. Priority of Distribution

The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is herein set forth. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

A. Class 1. The costs and expenses of administration, including but not limited to the following:

(1) the actual and necessary costs of preserving or recovering the assets of the insurer;

(2) compensation for all services rendered in the liquidation;

(3) any necessary filing fees;

(4) the fees and mileage payable to witnesses;

(5) reasonable attorney's fees;

(6) the reasonable expenses of a guaranty association or foreign guaranty association in handling claims.

B. Class 2. Debts due to employees for services performed to the extent that they do not exceed $1,000 and represent payment for services performed within one year before the filing of the petition for liquidation. Officers and directors shall not be entitled to the benefit of this prior-

ity. Such priority shall be in lieu of any other similar priority which may be authorized by law as to wages or compensation of employees.

C. Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property which are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligation of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to his employee shall be treated as a gratuity.

D. Class 4. Claims under nonassessable policies for unearned premium or other premium refunds and claims of general creditors.

E. Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of

such claims shall be postponed to the class of claims under Subsection H.

F. Class 6. Claims filed late or any other claims other than claims under Subsection G and H.

G. Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in accordance with law.

H. Class 8. The claims of shareholders or other owners.

APPENDIX D

The following states have adopted the principle of paying policyholder claims before those of the federal government:

Alaska Stat. §§ 21.78.180 and 21.78.260 (1978); Ariz. Rev. Stat. Ann. §§ 20-629 (1982) and 20-637 (1984); Ark. Stat. Ann. § 23-68-126 (1988); Conn. Gen. Stat. § 38-462 (1980); Fla. Stat. § 631.271 (1987); Ga. Code Ann. § 33-37-20 (1986); Idaho Code § 41-3342 (1981); Ind. Code § 27-9-3-40 (1979); Iowa Code § 507C.42 (1988); Kan. Stat. Ann. § 40-3601 (1986); Ky. Rev. Stat. § 304.33-430 (1982); La. Rev. Stat. Ann. § 22:746 (1987); Maine Rev. Stat. Ann. tit. 24-A § 4379 (1980); Md. Code Ann. Art. 48A § 158A (1987); Mich. Comp. Laws § 500.7834 (1984); Minn. Stat. § 60B.44 (1987); Mont. Code Ann. § 33-2-1371 (1979); Neb. Rev. Stat. § 44-127.25 (1984); Nev. Rev. Stat. § 696B.420 (1980); N.H. Rev. Stat. Ann. § 402-C:44 1987); N.M. Stat. Ann. § 59A-41-44 (1984); N.Y. Ins. Law § 7435 (1985); N.C. Gen. Stat. § 58-155.15 (1987); Ohio Rev. Code Ann. § 3903.42 (1983); Okla. Stat. tit. 36 § 1927 (1983); Pa. Cons. Stat. § 40-11-426 (1982); R.I. Gen. Laws § 27-14-22 (1987); S.C. Code Ann. § 38-27-610 (1988); Tenn. Code Ann. § 56-9-127 (1981); Tex. Ins. Code Ann. § 21.28-B (1984); Utah Code Ann. § 31A-27-335 (1986); V.I. Code Ann. tit. 22, § 1277 (1985); W. Va. Code § 33-10-19a (1985); Wis. Stat. § 645.68 (1980); and Wyo. Stat. § 26-28-125 (1983).

Supreme Court, U.S.
FILED
APR 14 1989

No. 88-1265

In the Supreme Court of the United States

OCTOBER TERM, 1988

ANTHONY J. FAGIANO, DIRECTOR, DEPARTMENT OF INSURANCE OF IDAHO, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether an Idaho statute establishing the priority of various classes of claims against the assets of a liquidating insurance company regulates the "business of insurance" within the meaning of Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. 1012(b), so as to displace the priority conferred by 31 U.S.C. 3713 for claims by the federal government.

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A28) is reported at 858 F.2d 445. The opinion of the district court (Pet. App. A29-A36) is reported at 662 F. Supp. 60.

JURISDICTION

The judgment of the court of appeals was entered on September 7, 1988. A petition for rehearing was denied on October 31, 1988 (Pet. App. A37). The petition for a writ of certiorari was filed on January 27, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Fagiano, the Director of the Idaho Department of Insurance, is the liquidator of two insol-

vent companies, Pacific Insurance Administrators Agency, Inc., and Pacific Insurance Administrators, Inc., formerly engaged in the insurance business in Idaho. In 1983, because of their financial problems, the companies agreed to cease doing business, to surrender possession of their assets to the Director, and to accept liquidation. During the liquidation process, the United States submitted claims for federal taxes owed by the insurance companies showing that Pacific Insurance Administrators Agency, Inc., owed the United States $25,514, and that Pacific Insurance Administrators, Inc., owed the United States $88,482. Pet. App. A4-A5.

The State of Idaho has laws that regulate insurance companies, including provisions that address the liquidation of insolvent insurance companies. See Idaho Insurers Supervision, Rehabilitation and Liquidation Act, Sections 41-3301 through 41-3360 of the Idaho Code. Section 41-3342 of the Idaho Code establishes a priority scheme for the payment of claims against a liquidated insurer in which governmental claims receive a lower priority than claims of general creditors. Pet. App. A6.[1]

The Director, as liquidator of the two companies, assigned a fifth priority to the government's tax claims pursuant to the Idaho statute. This priority would not have allowed the government to collect its delinquent taxes because the liquidation proceeds were insufficient to pay

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[1] The priority scheme of Section 41-3342 provides generally for the payment of eight classes of claims according to the following priority: administrative expenses (Class 1), certain wage claims of employees (Class 2), claims for policy losses (Class 3), claims under nonassessable policies and claims of general creditors (Class 4), governmental claims (Class 5), late filed claims in classes 1-5 (Class 6), surplus or contribution notes and premium refunds on assessable policies (Class 7), and claims of shareholders or owners (Class 8). See Pet. App. A26-A28.

both fourth priority claims, which consisted principally of the claims of approximately 150 general creditors, and fifth priority claims. The government asserted, however, that the priority of its claims was governed by the Federal Insolvency Statute, 31 U.S.C. 3713. That statute provides that claims of the United States shall be paid first whenever an insolvent person indebted to the federal government has made a voluntary assignment of property or has committed an act of bankruptcy. Pet. App. A6-A7.[2]

2. The Director obtained an order from the Ada County District Court permitting him to set aside funds to pay the government's claims, and he then brought this interpleader action in the United States District Court for the District of Idaho to resolve the priority dispute (Pet. App. A7). Relying on Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. 1012(b), the Director contended that State law controlled the priority of the federal government's claims. Section 2(b) provides in pertinent part that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance" (see Pet. App. A38). The district court agreed with this contention and held that the priorities in liquidation were governed by the Idaho statute (Pet. App. A29-A36). The court reasoned that Section 41-3342 of the Idaho Code was part of the overall regulatory scheme of the insurance industry established by Idaho and therefore that the provision regulated the "business of insurance" within the meaning of the McCarran-Ferguson Act (Pet. App. A34-A35).

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[2] Section 3713 does not apply to cases under the federal bankruptcy statute. Insurance companies are excluded from that statute. 11 U.S.C. 109(b)(2).

3. The court of appeals reversed (Pet. App. A1-A28), concluding that Section 41-3342 does not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act. The court observed that "both Congress and the courts have declared that the McCarran-Ferguson Act was not intended to open new areas of regulatory discretion to the States" (Pet. App. A13). Rather, the court explained, the McCarran-Ferguson Act was intended only to return to the states the power to regulate insurance transactions that had been put in doubt by *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).[3] Quoting this Court's decision in *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 460 (1969), the court of appeals stated that the term "business of insurance" in the McCarran-Ferguson Act refers primarily to "[t]he relationship between insurer and insured" (Pet. App. A17). The court concluded that, under *National Securities,* the Idaho statutory provision, which addresses only a situation where the business of insurance has ceased and "is wholly unrelated to the relationship between insurer and insured," cannot be encompassed within Section 2(b) of the McCarran-Ferguson Act (Pet. App. A18-A19). The court of appeals added (*id.* at A19-A23) that the Idaho statute also does not satisfy any of the criteria of a statute regulating the "business of insurance" that this Court later identified in the progeny of *National Securities—Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979), and *Union Labor Life Ins. Co.* v. *Pireno,* 458 U.S. 119 (1982).

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[3] *South-Eastern Underwriters* overruled an earlier decision holding that insurance transactions were not "commerce," and it created concern over the continued validity under the Commerce Clause of existing state regulatory and taxing schemes. See Pet. App. A12-A13; pages 5-6, *infra.*

ARGUMENT

The court of appeals correctly held that the Idaho statute does not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act. That decision fully accords with the relevant decisions of this Court and does not conflict with any decision of another court of appeals.[4] Indeed, this Court recently denied certiorari in a case raising precisely the same issue presented here. *Gordon* v. *United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), cert. denied, 109 S. Ct. 390 (1988). There is no more reason to grant certiorari here than there was in *Gordon*.

1. There is no merit to petitioners' contention (Pet. 8-12, 18-20) that the Idaho statute pertains to the "business of insurance" within the meaning of the McCarran-Ferguson Act simply because part of the liquidator's duties are to consider and pay the claims of policyholders of the insolvent insurance companies. Once an insurance company is in liquidation, it is no longer in the business of insurance. While the insurer's assets must be distributed among various creditors, some of whom are policyholders

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[4] The decision below is also in accord with the only state appellate court decision of which we are aware that addresses this issue, *Langdeau* v. *United States*, 363 S.W.2d 327 (Tex. Civ. App. 1962). The court in *Langdeau* rejected the contention that a state statute establishing a priority for unpaid wage claims over federal tax claims on the liquidation of an insurance company constituted regulation of the "business of insurance" under the McCarran-Ferguson Act. The court explained that "[t]here are many statutes regulating the rights of persons who may have claims against an insurance company * * * yet it would hardly be contended that these laws regulate the insurance business simply because they may be invoked against an insurance company" (*id.* at 331). The court held, accordingly, that the United States had priority under the predecessor of Section 3713 for its claims for unpaid taxes and interest thereon.

with claims based on their policies, the determination of the priority according to which those claims should be paid is a matter of insolvency administration, not the "business of insurance."

The history of the McCarran-Ferguson Act makes clear that it was never intended to sweep so broadly as to permit the states to determine priorities in insolvency proceedings without regard to otherwise applicable federal law. The McCarran-Ferguson Act was enacted in response to this Court's decision in *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), in which the Court held that interstate insurance transactions are "commerce" subject to Congress's power to enact legislation under the Commerce Clause. The McCarran-Ferguson Act was designed to allay fears that, as a result of this holding, traditional state regulation of insurance could be invalidated by negative implication of the Commerce Clause. It is clear, however, that the McCarran-Ferguson Act was intended only to *return* the regulation of insurance transactions to the states, not to expand the power of the states to act in the face of conflicting federal statutes. As this Court explained in *SEC* v. *National Securities, Inc.*, 393 U.S. at 459:

> The McCarran-Ferguson Act was an attempt to turn back the clock, to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation. As the House Report makes clear, "[i]t [was] not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern*

> *Underwriters Association* case." H.R. Rep. No. 143, 79th Cong., 1st Sess., 3 (1945).

The Court reiterated this explanation in *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205, 218 n.18 (1979) (emphasis deleted), stating that the "primary purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case," that is, to permit the States to continue such regulation "without fear of Commerce Clause attack." See also *Maryland Casualty Co.* v. *Cushing*, 347 U.S. 409, 413 (1954) (plurality opinion); H.R. Rep. No. 143, 79th Cong., 1st Sess. 3 (1945); H.R. Rep. No. 68, 79th Cong., 1st Sess. 2 (1945).

It follows that the "business of insurance" in the Act does not encompass regulation of the priority accorded to debts owed to the federal government by an insolvent insurance company. The priority accorded to debts owed to the federal government has never been regarded as a matter within the province of state regulation; rather, that matter has been governed by the Federal Insolvency Statute since virtually the beginning of the Republic. See Act of Mar. 3, 1797, ch. 20, § 5, 1 Stat. 515, as amended by Act of Mar. 2, 1799, ch. 22, § 65, 1 Stat. 676; *United States* v. *Oklahoma*, 261 U.S. 253, 259 (1923). And, prior to the enactment of the McCarran-Ferguson Act, it was not doubted that the statute was fully applicable to insolvency of insurance companies. See *United States* v. *Knott*, 298 U.S. 544, 547 (1936). Moreover, this long-standing federal statute has no connection with the Commerce Clause concerns that prompted the McCarran-Ferguson Act; it derives from Congress's comprehensive powers under Article I, Section 8 of the Constitution to "pay the Debts" and to establish "uniform Laws on the

subject of Bankruptcies." See *United States* v. *Fisher*, 6 U.S. (2 Cranch) 358, 396 (1805). Thus, the decision below and that of the Fourth Circuit in *Gordon* have not created a "legal quagmire" (Pet. 15); they simply reaffirm that, despite the McCarran-Ferguson Act, the Federal Insolvency Statute continues to apply according to its terms to determine the priority of debts owed to the government in state insolvency proceedings.[5]

As the court of appeals explained (Pet. App. A16-A19), this Court's decision in *National Securities* itself makes plain that the McCarran-Ferguson Act extends to the states exclusive regulatory authority only over those activities of insurance companies that constitute the business of insurance, which does not encompass the priority provision involved here. In *National Securities,* the Court held that an Arizona statute under which the State Director of Insurance had approved the merger of two insurance companies did not regulate the "business of insurance" and therefore the McCarran-Ferguson Act did not allow it to displace the operation of the federal securities laws. The Court explained that the Arizona statute regulated the relationship between stockholders and insurance companies, not "between insurer and insured" (393 U.S. at 460). Similarly here, the court of appeals correctly concluded that the Idaho priority statute does not regulate the relationship between an insurer and its policyholders, but rather regulates the relationship among the various creditors of insolvent corporations, albeit corporations

[5] Petitioners' contention (Pet. 16) that this Court should grant review to resolve a "conflict" between the Idaho statute and the Federal Insolvency Statute is misconceived. Such a "conflict" is resolved by the Supremacy Clause of the Constitution, and petitioners' plea that "[t]his Court should not allow a general application federal statute to override the provisions of a narrowly tailored state insurance statute" (*ibid.*) is foreclosed by that Clause.

that had engaged in the business of insurance. Such regulation of the relationship between one creditor and another is far afield from the "business of insurance" to which the McCarran-Ferguson Act is directed.[6]

Moreover, both the court below (Pet. App. A19-A23) and the Fourth Circuit in *Gordon* v. *United States Dep't of the Treasury*, 846 F.2d at 273-274, correctly concluded that the three criteria articulated in *Group Life & Health Ins. Co.* v. *Royal Drug Co., supra,* and *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119, 129 (1982), for determining whether a state-regulated activity constitutes the "business of insurance" within the meaning of the McCarran-Ferguson Act all support the decision below. Contrary to amicus curiae's suggestion (NAIC Amicus Br. 10-12), the Idaho statute plainly does not regulate the spreading of *insurance* risks—the transfer of the insurance risk "is complete at the time that the [insurance] contract is entered" (*Pireno*, 458 U.S. at 130). Nor does the statute address an integral part of the policy relationship between the insurer and the insurer; instead, it governs the rela-

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[6] Petitioners clearly err in suggesting (Pet. 17) that the priority provision, Section 41-3342 of the Idaho Code, must be regarded as regulation of the "business of insurance" because it is part of a comprehensive statutory scheme enacted by the Idaho legislature to regulate the insurance industry in Idaho. As the court of appeals stated, this contention "begs the question" whether the "specific provision constitutes the type of regulation that Congress sought to protect from indirect federal preemption by passing the McCarran-Ferguson Act" (Pet. App. A24). Surely, a state legislature cannot bring a regulation that does not address the "business of insurance" within the scope of the McCarran-Ferguson Act simply by placing the provision in the midst of a set of provisions that generally regulate the business of insurance. The determination whether Congress intended to grant exclusive regulatory authority to the states on a particular matter cannot depend upon where the state's regulatory provision is placed in its statutory code.

tionship between creditors, including all creditors of the insurance company and not merely the policyholders. And the statute establishing the priority of all creditors' claims manifestly is not limited in its effect to entities within the insurance industry; it governs the creditor's rights of a variety of entities outside the insurance industry.

Petitioners urge (Pet. 11) that these three criteria are applicable only where the antitrust exemption of the McCarran-Ferguson Act is at issue, as was the case in both *Royal Drug* and *Pireno*. First, even if this contention had merit, it would not avail petitioners since the court of appeals was correct in concluding (Pet. App. A16-A19) that it is unnecessary to refer to the antitrust exemption cases in order to conclude that the statute at issue here does not regulate the "business of insurance." In any event, petitioners' contention is clearly mistaken.

Both *Pireno* and *Royal Drug*, like this case, applied Section 2(b) of the McCarran-Ferguson Act. By its terms, that section resolves any conflict between an "Act of Congress" that does not "specifically relate[] to the business of insurance" and a state law "enacted * * * for the purpose of regulating the business of insurance." In this regard, Section 2(b) does not distinguish between antitrust statutes and other statutory provisions, and thus it permits no variation in the meaning of the phrase "business of insurance" that is dependent upon the particular federal statute involved. If a state law regulates the "business of insurance," it supersedes all inconsistent general federal statutes; if it does not, it is subordinate to all such federal laws. Indeed, this Court has repeatedly referred to the three criteria identified in *Pireno* and *Royal Drug* as generally delineating the scope of the phrase "business of insurance" under the McCarran-Ferguson Act, without suggesting that their use should be restricted to the antitrust context. See *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S.

41, 48-49 (1987); *Metropolitan Life Ins. Co.* v. *Massachusetts*, 471 U.S. 724, 743 (1985).

2. There is no merit to petitioners' contention (Pet. 12-15) that the decision below creates a conflict in the circuits that requires resolution by this Court. The suggestion that the court of appeals' decision conflicts with the Fourth Circuit's decision in *Gordon* is fanciful. Both courts held that, despite the McCarran-Ferguson Act, the terms of the Federal Insolvency Statute override a state statute assigning priorities to the claims of creditors of an insolvent insurance company. Both courts ruled that this reading of McCarran-Ferguson is compelled by application of the three criteria identified by this Court in *Royal Drug* and *Pireno*. The only difference in the two decisions is that, in the instant case, the court of appeals also stated that the same result is compelled by an earlier decision of this Court, *National Securities*, without the need to resort to the three-factor test. Thus, there is no conflict at all between the two decisions, much less one that warrants a grant of certiorari.

Nor does the decision below conflict in any way with the other cases cited by petitioners, which all involved the "abstention doctrine" and did not apply the McCarran-Ferguson Act to find a federal statute inapplicable because a state statute was viewed as regulating the "business of insurance." The Second and Tenth Circuit cases (*Grimes* v. *Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988), cert. denied, No. 88-1155 (Mar. 27, 1989); *Law Enforcement Ins. Co.* v. *Corcoran*, 807 F.2d 38 (2d Cir. 1986), cert. denied, 481 U.S. 1017 (1987); *Levy* v. *Lewis*, 635 F.2d 960 (2d Cir. 1980)) each presented the issue whether it was appropriate for the federal court to exercise its discretionary power to abstain from adjudicating a claim against an insolvent insurance company, where the state regulatory scheme committed such claims to a single state liquidation

proceeding. In resolving that issue, the courts recognized the policies underlying the McCarran-Ferguson Act as a factor weighing in favor of abstention. But in none of the cases did the courts hold that state law displaced a federal right or that an insurer liquidation statute regulates the "business of insurance."[7] Indeed, the Second Circuit in *Levy* made clear that the federal law that had been invoked (ERISA) was not subordinated to state law under the McCarran-Ferguson Act, stating that "the Act was meant only to free state regulation 'of the business of insurance' [quoting *National Securities,* 393 U.S. at 459-460], not regulation of insurers as employers * * *." 635 F.2d at 966. See also *Lac D'Amiante du Quebec, Ltee.* v. *American Home Assurance Co.,* 864 F.2d 1033, 1039 n.8 (3d Cir. 1988) (noting that abstention inquiry does not require determining whether state regulation constitutes regulation of the business of insurance within the meaning of McCarran-Ferguson Act).

The other case relied upon by petitioners, *United Services Auto. Ass'n* v. *Muir,* 792 F.2d 356 (3d Cir. 1986), cert. denied, 479 U.S. 1031 (1987), did not even concern an insolvent insurance company. The issue there was whether a federal court should abstain from deciding whether a Pennsylvania statute, which prohibited an insurer that owned a bank in another state from simultaneously conducting an insurance business in Pennsylvania, was either unconstitutional or preempted by federal banking legislation. 792 F.2d at 359-360. Moreover, the court ruled that abstention was not appropriate

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[7] *Grimes* and *Law Enforcement Ins. Co.* did not even involve claims grounded in federal law (see 857 F.2d at 705; 807 F.2d at 44), and therefore they clearly do not suggest that a federal rule of substantive law governing priority of federal claims against an insolvent debtor must give way to a contrary state statute.

in that case, stating both that regulation designed to prevent competition between insurers and Pennsylvania financial institutions is not regulation of the "business of insurance" under the McCarran-Ferguson Act and that the Pennsylvania statute is not otherwise so integral to the state's complex regulatory scheme governing insurance as to justify invoking the doctrine of abstention. 792 F. 2d at 364-365. Plainly, the decision below does not conflict with *United Services*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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